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CIS

RECLAIMING THE TAX CODE FOR AMERICAN FAMILIES

HEARING

BEFORE THE

SELECT COMMITTEE ON CHILDREN, YOUTH, AND FAMILIES HOUSE OF REPRESENTATIVES

ONE HUNDRED SECOND CONGRESS

FIRST SESSION

HEARING HELD IN WASHINGTON, DC, APRIL 15, 1991

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RECLAIMING THE TAX CODE FOR AMERICAN FAMILIES

MONDAY, APRIL 15, 1991

House of Representatives,
Select Committee on Children, Youth, and Families,
Washington, DC.

The select committee met, pursuant to call, at 10:02 a.m., in Room 2212, Rayburn House Office Building, Hon. Patricia Schroeder (Chairwoman of the committee) presiding.

Members present: Representatives Schroeder, Sarpalius, Horn, Wolf, Hastert, Smith of Texas, McEwen, Klug, Camp and Barrett.

Staff present: Karabelle Pizzigati, staff director; Jill Kagan, deputy staff director; Nancy Reder, professional staff; Danielle Madison, minority staff director; Carol Statuto, minority deputy staff director; Barbara Comstock, professional staff; Elizabeth Maier, professional staff; and Joan Godley, committee clerk.

Chairwoman **Schroeder**. I'm going to go ahead and call this hearing to order, because I believe it's very important to be efficient and timely. So I want to thank everyone for coming this morning. We all look forward to getting into a very, very interesting topic.

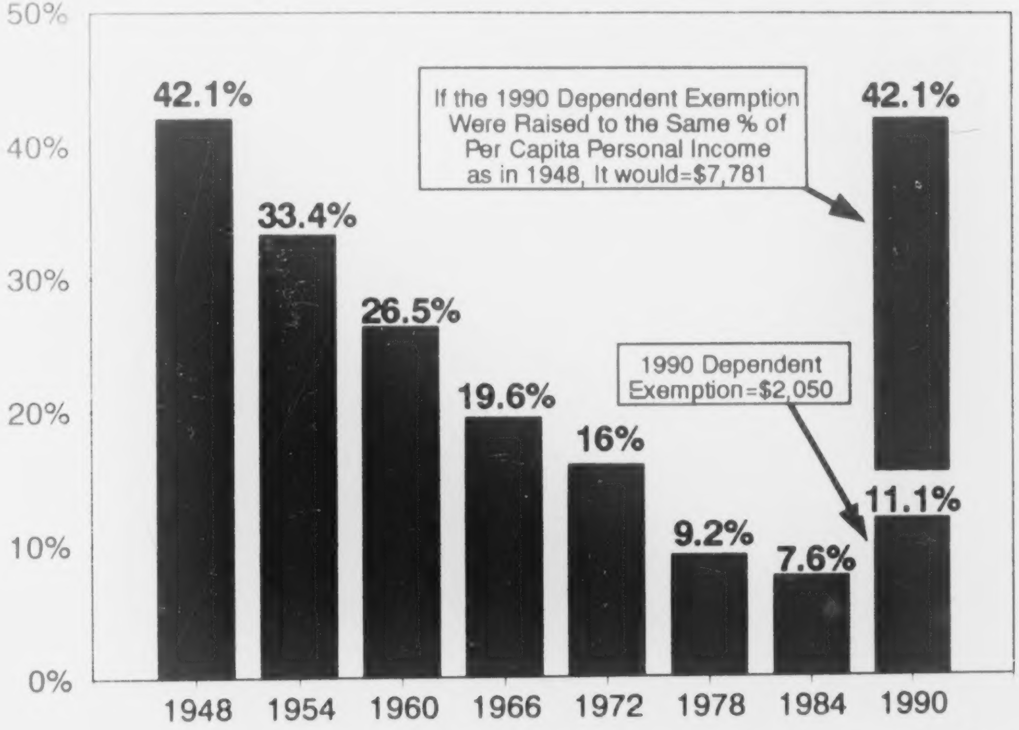
I am honored to be chairing this committee, and I realize George Miller left some very, very big shoes to fill, but I will do everything I can to fill them.

I'm going to ask unanimous consent to put my opening statement in the record and just kind of summarize.

By the time we get done today, we certainly hope that America's families are "seeing red" about what has happened to them in the tax code. We also brought a slide over there to show people how America's families have kind of fallen down this revenue slide and gotten deeper and deeper into having to share a higher burden than they used to share back in 1948.

[The chart follows:]

Dependent Exemption as a Percent of Per Capita Personal Income, 1948 - 1990



Source: Steuerle and Juffras; 1991; The Urban Institute. Based on data from the I.R.S. "Statistics of Income," and the Bureau of Economic Analysis.

Chairwoman **Schroeder**. We are going to have a very interesting talk about the personal exemption, which is fascinating, because both groups on the right end of the spectrum and the left end of the spectrum are now coming together and saying the personal exemption certainly should be increased.

Using 1948 as the target date for when they put it in, if you increased it to that level—and we'll be showing the charts about this—if you increased it to the 1948 level and sheltered family income, it would be $7,800 per person. I think that would make a great difference in America's family life.

We're not even going to have enough time to dent all the things we would like to dent in this tax code issue. Number one, we won't really get that heavily into the Social Security tax, which hits families doubly hard. And that's been a big tax shift as of late. We won't get into enough detail about what other citizens pay for their taxes compared to Americans, and then what they get for their taxes compared to Americans. Because when you add the American tax burden and put the American family tax burden out there with, say, a Canadian family's tax burden, or a European's or an Asian's, at first blush it looks like Americans are doing better. But then when you add in all the things that Americans have to buy personally, such as health care, college tuition and everything else, which is covered automatically through taxes in other countries, you find out we're the most overtaxed families on the planet once again.

So this has been a really incredible process. Since 1948 until today, with this tax shifting continuing, America's families are really the Atlas now of the revenue for the United States Government, holding it on their shoulders. We want a little of it shifted off their shoulders and the burden distributed a little more fairly.

So we are going to start that process today. I think economic equity for families is going to be one of our great rallying cries, and we want to see all the groups kind of united here together to make sure this shifting stops and fairness starts. I think that will give families a lot more security in the future.

[Opening statement of Hon. Patricia Schroeder follows:]

OPENING STATEMENT OF HON. PATRICIA SCHROEDER, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF COLORADO AND CHAIRWOMAN, SELECT COMMITTEE ON CHILDREN, YOUTH, AND FAMILIES

Today is tax day—the day our federal taxes are due to the federal government *and* the opening day of a revolution by American families to reclaim the tax code. For too long America's families—especially middle-income families—have been footing more than their fair share of the nation's tax bill. We can no longer ignore the detrimental effect that this massive tax shift has had on the economic well-being of America's families.

As the slide before us so graphically illustrates, our families have been headed down an economic decline. As the new Chairwoman of the Select Committee on Children, Youth, and Families, I trust that our Committee will be able to continue the work begun under the first steward of the Committee my esteemed colleague, George Miller, and continuously stir Congress to action on behalf of our nation's children and families.

My concern for the tax burden on families is not new. For years I have been arguing for an increase in the personal exemption as a means of reducing the tax burden on families; in fact, I introduced legislation back in 1984 to increase the personal exemption to $2,600, a goal that we fell short of with tax reform in 1986. Unfortunately, tax reform seems to have fallen short of its goal of providing meaningful tax relief for middle-income families and that is one reason why we are here today.

Just a quick look at federal revenue can show how the tax burden has shifted. In 1967, federal revenues raised from corporate taxes were 4% of Gross National Product (GNP). Roughly 20 years later, they were half that. During that same period of time, social security payroll taxes went up and personal income taxes took a bigger bite out of families' take home pay. As a result, even though 1986 tax reform was supposed to lower taxes for all families, the effective tax rate for low- and middle-income families was higher in 1990 than it was in 1980.

This isn't the way it was supposed to be. In 1913, when the first income tax act was enacted, the law contained a personal exemption of $3,000 for each taxpayer and $1,000 for his or her spouse. While there was no dependent exemption, the standard tax rate was 1%, which was accompanied by a regressive surtax of 1 to 5%. The high personal exemption played the role of today's personal exemption and the standard deduction and it was sufficiently large so that only a small portion of citizens owed any tax at all.

By 1948, after several changes in the intervening 35 years, the exemption was set at $600 for single taxpayers and dependents and $1,200 for couples and heads of families. The median family income was $3,187 and families paid .3% of their income in federal income taxes. Since that time, the value of those exemptions has continued to erode due to inflation. Not withstanding the 1986 tax change that doubled the amount of the personal and dependent exemptions to $2,000 and indexed them for inflation, the value of those exemptions had continued to erode. In fact, to be equivalent to that $600 today, the personal exemption would have to be around $7,000.

I have long been concerned about the eroding value of the personal exemption, which is one of the very few ways that our government addresses the costs involved in raising a family. Those costs, as we all know, have risen dramatically in the past few years and extend to virtually every aspect of a child's life.

Health care costs are spiraling out of control and children need preventive care on a regular basis as well as care for acute or chronic needs. The median price of new and existing homes just about doubled between 1977 and 1986 as did the cost of a four-year college education.

At the same time, real incomes were falling for many American families and more and more families need a second income to keep them afloat. This income squeeze has propelled mothers into the paid labor force.

The second major way that families have paid for these spiraling costs has been to increase the amount of debt that they have taken on. This translates into bigger mortgage payments and credit card expenditures that are carried over from month to month.

The U.S. Department of Agriculture estimates that raising a child born in 1990 through age 18 will cost a minimum of $150,200 and that's the estimate for a low-income family! Middle-income families can expect to spend more than $200,000.

If we look at what changes have been made in federal tax policy over the past ten years or so to help our nation's family, quite frankly, it's a mixed bag. The Tax Reform Act of 1986 removed six million poor taxpayers from the tax rolls. And the expansions of the Earned Income Tax Credit in the last Congress are expected to further benefit the poor. But the 1986 law also eliminated the second-earner deduction that was designed to reduce the marriage penalty tax. Social security payroll taxes have increased 23% between 1980 and 1990.

This morning's hearing is designed to help us begin to evaluate alternative tax policies that can make the tax code more "family-friendly." We have with us a array of experts who will help the Select Committee members sift through a variety of options. I would like to welcome everyone who is here and I look forward to a stimulating and informative hearing.

RECLAIMING THE TAX CODE FOR AMERICAN FAMILIES

A FACT SHEET

TAX BURDEN OF MIDDLE-INCOME FAMILIES CONTINUES TO INCREASE

- In 1990, federal, state, local and social security taxes accounted for 25% of median family income compared with 23% in 1970 and just 14% in 1960. (Progressive Policy Institute [PPI], 1990)

- In 1948, a median-income family of four paid only .3% of its income in federal taxes and 1.5% of earnings (up to $3,000) in social security taxes. By 1990, a median-income family of four paid about 9% of its income in federal taxes and 7.65% of earnings (up to $51,300) in social security taxes. (Committee on Ways and Means, U.S. House of Representatives, 1990; PPI, 1990)

- If the 1948 personal exemption had been adjusted for inflation, it would be equal to $3,000 today. If it were adjusted to reflect the same proportion of median income that it did in 1948, it would be the equivalent of $6,000. (PPI, 1990)

- Between 1977 and 1990, federal tax rates for the top 1% of taxpayers (average 1990 income $549,000) decreased 15%, while federal tax rates for middle-income taxpayers (average 1990 income $30,960) increased by more than 1% and for moderate-income families (average 1990 income $19,350) by 2%. (McIntyre, 1990)

- Since 1967, federal revenues raised from corporate income taxes have fallen from 4.3% of Gross National Product (GNP) to 1.7% in 1990. During the same time, revenues from individual income taxes increased from 7.7% of GNP to 8.6% and revenues from social security taxes increased from 4.1% to 7%. (Congressional Budget Office, 1991)

COST OF RAISING CHILDREN CONSUMES FAMILY RESOURCES

- The estimated costs of raising a child born in 1990 to age 17 are $151,170 for low-income families, $210,070 for middle-income families, and $293,400 for upper-income families. (U.S. Department of Agriculture, 1990)

- The median sales price for existing single-family homes nationwide rose from $23,000 in 1970 to $95,500. The cost of housing was significantly higher in the northeast and western regions of the country. (National Association of Realtors, 1990)
- In March 1990, 67% of all women with children under 18 were in the labor force. Families spend an estimated $15.5 billion annually on child care. (U.S. Bureau of the Census, 1990)
- By the year 2000, per capita spending on health care is projected to rise to $5,515, an increase of 443% from 1980. Families will experience a 512% increase in out-of-pocket health care costs between 1980 and 2000, from $63 billion to $386 billion, not counting health insurance premiums. (Families USA, 1990)
- The cost of a college education continues to outpace inflation. In 1986/87, the average annual cost of postsecondary education ranged from $4,138 at a public institution to $10,039 at a private one. The comparable figures for 1976/77 were $1,935 and $3,977. (U.S. Department of Education, 1990)

FAMILY INCOMES DECLINE IN THE 1980s

- Between 1977 and 1990, middle-income families saw their real income decline by 6%. For moderate-income families, the drop was 9%. After-tax declines were even steeper, averaging an additional percentage point for each income group. (McIntyre, 1990)
- The median income for single-parent families fell 9% (from $15,210 to $13,620) between 1979 and 1987. (Congressional Research Service, 1990)
- Between 1973 and 1979, real median family income for young families (with a household head ages 25-34) grew by 2.9%, but fell 4.8% between 1979 and 1988. (Mishel, 1990)

FAMILIES BORROWING MORE MONEY TO MAKE ENDS MEET

- In 1988, the level of household debt relative to disposable income reached a post World War II high of 94%. (Pollin, 1990)
- Between 1970 and 1986, families with incomes less than $17,500 (in 1986 dollars) experienced the greatest relative increases in debt/income ratios. (Pollin, 1990)

April 15, 1991

Chairwoman **Schroeder**. I want to thank you all for coming, and let me introduce the new ranking member to you. We not only have a new chair but a new ranking member, Congressman Frank Wolf from Virginia.

Mr. **Wolf**. Thank you, Pat.

I would like to start by asking unanimous consent to revise and extend and put my statement in the record.

Chairwoman **Schroeder**. Surely.

Mr. **Wolf**. I want to thank Congresswoman Schroeder for the first act she has done as Chairwoman of this committee, to hold these hearings. I have legislation which Congresswoman Schroeder has also cosponsored with about 59 other Members of the House which would increase the personal standard deduction exemption, if you will, for children, from the current $2,050 to $3,500. For those who are wondering, it is very doable within the budget package that was passed, so this is not a budget buster and should not be opposed simply because someone has said we cannot afford it.

I might say at the outset that I did support the budget package and feel restrained to live within it. This is within it. So there is no excuse not to support it.

Secondly, to reiterate something that was said the other day, the American family really doesn't have any major lobbyist for it here in town. There are very few Cabinet officials and high-ranking Government officials, Congressmen and Senators, when they leave Government, who go out and work for the family. Most of the time they go downtown and work for big law firms which represent different interests.

There's nothing wrong with that, but if you look and see, the American family is not well represented in the Halls of Congress. Every time there is a major tax bill passed, just go by the Ways and Means Committee—which is a "Gucci Gulch," if you will—and there really isn't anybody looking out for the personal exemption, dependent deduction, child care, and the different things like that for the American family. They are basically without representation. I think this committee has an opportunity to change that.

Lastly, the purpose of all of this is to help moms and dads to spend more time with their families. The old argument that it's not the quantity of time but the quality of time really doesn't hold true. It is the quality of time as well as the quantity of time. Without quantity, there is very little quality. As many of you know, values for children are not only taught to children; they are caught by children. If moms and dads are not home with their children, it is very difficult to teach those values and it is very difficult for the children to catch those values.

So one of the proposals of increasing the personal exemption deals with all of these issues. And it's very simple. It does not require a new building in Washington. It does not require more Federal employees. It does not require new regulations. It is so simple that I think the simplistic part of it is part of the magic which allows moms and dads to keep more of their own money to spend on whatever they want to spend it on.

I want to again thank Congresswoman Schroeder for holding these hearings.

[Opening statement of Hon. Frank Wolf follows:]

Opening Statement of Hon. Frank R. Wolf, a Representative in Congress From the State of Virginia and Ranking Republican Member of the Select Committee on Children, Youth, and Families

It is appropriate that on April 15 we look to the tax code and how it impacts families with children. Over the past four decades, the dramatic erosion of the personal exemption has been one of the most unfriendly family policies. Too many families, genuinely trying to do a good job raising children, have been stretched to the breaking point by tax policies that all but ignore them—they have become "America's forgotten families."

The family is under great cultural and fiscal attack today. Nearly every statistic on family well-being—from teen suicide rates to teen pregnancy—indicates that the family is in a downward spiral. Yet while children are more at risk, parents are pushed by financial pressures to spend less time with their children. The combined effect of these twin deficits of time and money threaten the future for many families. I am happy we are here today to put these forgotten families in the forefront of our discussion on family tax fairness.

The simplest and most effective way to reinvest in families is to allow them to keep more of their own hard earned money by providing tax relief specifically targeted to families with children. In 1948, a median income family of four had approximately three-quarters of its income shielded from federal income tax. Today that percentage has eroded to only one-quarter. If the personal exemption were to offset the same percentage of average income as it did in 1948, it would have been worth approximately $7800 in 1990. Because of this erosion in the personal exemption, families today are carrying an increasingly disproportionate burden of taxes.

I have proposed the "The Tax Fairness for Families Act of 1991" to increase the dependent deduction for children under 18 to $3,500. It has garnered the support of over 55 members of the House including all of the Republican members of this Select Committee, as well as Chairwoman Schroeder, Rep. Ted Weiss and Rep. Bud Cramer from the Majority. I am also encouraged that a number of those testifying here today, who represent a range of political viewpoints, have already called for an increase in the dependent deduction for children. It is an important first step in what I hope is a bipartisan effort to truly focus on the family in the 102nd Congress.

We should also consider other additional tax measures to make the Tax Code more "family friendly." We must remedy the inequity in the tax code between those who pay for child care and those who are unable to use paid child care or elect unpaid means of care. To accomplish this, we can create a Universal Young Child Tax Credit by raising the age, amount and income range of those eligible for a credit. This credit would provide tax relief to all families with young children, whether or not they are in one-earner or two-earner families. We can also develop tax language for an easier deduction to be taken for homebased offices that conduct their primary business from home. Additional tax protection to those families who adopt children and provide foster care should also be considered.

Today, more and more parents wish to spend more time with their children and want flexibility to allow for either taking time out of the workforce or cutting back their work hours. Many parents elect part-time jobs, job sharing situations or employ "tag team" parenting arrangements so that care is shared between two parents who work different shifts. Since child development experts agree that increased parental care and involvement is needed for today's children and it is what most parents want, we should not be financially closing off this option to families.

If we look for the most efficient Department of Health and Human Services in this country we will find that it is run by the thousands of "domestic engineers" who go by the title of "Mom and Dad." In comparison to government programs, families require much less overhead and oversight to perform effectively and should be provided the resources to do so. We should begin to reinvest in this department through tax relief targeted to families.

I appreciate this opportunity to pursue how we can provide tax fairness for families. Thank you, Chairwoman Schroeder.

Chairwoman **Schroeder**. Thank you very much.

We will put all opening statements in the record, unless anyone here on the panel wants to say anything. If that's all right, we will move on with our witnesses, because we have a lot of very interesting witnesses today.

[Prepared statements follow:]

Opening Statement of Hon. Lamar Smith, a Representative In Congress From the State of Texas

Madame Chair, the family is the foundation of our society.

The ability of parents to provide security, education and love for their children is crucial to the future of the United States.

There is no substitute for the love and care that a parent can give to his or her child.

Over the past several years, parents have been under increased economic pressures, making it more and more difficult to spend time with their children.

Parents pay higher taxes and higher mortgages, but the children pay the highest price of all.

Today, the Select Committee has the opportunity to address this problem.

It is encouraging to see strong bipartisan agreement that Congress must provide relief to families with children.

For example, the Tax Fairness for Families Act, which would increase the personal exemption for children under the age of 18 to $3,500, has strong bipartisan support.

The bill would put dollars back into the hands of parents so they could provide more to their children.

It would make it easier for parents to purchase a house for their children's security, save for their college education, or simply spend more time with their children.

The greatest concern of many people is the cost of such a bill to the U.S. Treasury.

Congress can easily cut spending to pay for relief for working families.

I recently introduced a proposal which would save billions of federal dollars.

Now in the form of a resolution, my proposal calls on the federal government to place better controls on overhead expenses and to reduce these indirect expenses by 10 percent in fiscal year 1992.

The money saved with the adoption of this proposal could be given back to American families.

Providing relief for children is the best investment in the future that Congress can possibly make.

Prepared Statement of Hon. Mike Bilirakis, a Representative in Congress From the State of Florida

Madame Chair, I commend you for holding this hearing today on an issue vital to the welfare of American society—the fairness of the tax code to the middle class family. Too often, the needs of the family are ignored as we develop and change our tax policies.

More and more as we move into the 1990's, the American family unit is being headed by single women, due to divorce or other circumstances. This family unit suffers financially, as single mothers struggle to work, raise their children and provide day care for these children. If they cannot find employment, however, single women raising children cannot survive financially in today's society.

Many women in a group known as the displaced homemakers fall into this category. Displaced homemakers are primarily women who have been full-time homemakers for a number of years, but who have lost their source of economic support due to divorce, separation, abandonment, or the death or disability of a spouse. They are often neglected by our tax structure and suffer financially as a consequence.

Madame Chair, I am not talking about women whose husbands have died and left them well off, or about women who receive substantial alimony or child support payments. I am talking about poor women who have been out of the work force and cannot find decent jobs either because of a lack of job skills or an employer's unwillingness to hire them because they haven't worked in years or have never worked outside of the home.

These women are struggling to make ends meet without unemployment insurance, without health insurance, and without jobs.

These are not only elderly women, even though prime working years are usually considered to be up to age 64. Displaced homemakers can be in their late 20's, 30's, or 40's. They may have a number of children or they may have none. However, the basic fact is that they need housing, medical care, and food to eat . . . all of which they could pay for if they had jobs.

Madame Chair, the statistics on displaced homemakers are shocking. The displaced homemakers network here in Washington, which represents local programs serving displaced homemakers nationwide, indicates in one of its studies that women and children suffer a 73 precent decline in their standard of living the first year after a divorce, while men experience a 42 percent increase. I believe that we can all appreciate the inequity of this situation, and it is obvious who the victims are.

A 1985 congressional Office of Technology assessment study further confirms that many displaced homemakers are living at or near poverty levels. Nearly half had family incomes below $10,000. Most of those displaced homemakers under age 35 are living with children and most of them are poor. The question is obvious—how can we expect children who are brought up in poverty-ridden single parent homes to reach their full potentials?

We are not talking about a small group of people either. A network status report on displaced homemakers and single parents in the United States states that there are 11.4 million displaced homemakers in the Nation. Further, two thirds of all displaced homemakers are widows and 30 percent are divorced or separated. Nearly half have completed high school, including 18 percent who have obtained some education beyond high school. Any woman who has succeeded in running a home certainly has skills that will fit into a working environment outside the home. I feel that they should be given a chance to work.

In an effort to give displaced homemakers an opportunity for meaningful employment and job dignity, I have consistently introduced legislation which would amend the Internal Revenue Code to allow employers a tax credit for hiring displaced homemakers. Basically, this legislation is intended to be an encouragement for employers to hire those who have been out of the work force because of family obligations.

In these deficit-ridden times, we need productive people who will be contributors to the coffers, not recipients of assistance. An investment in helping these women obtain jobs and learn skills, through a tax credit to prospective employers, will enhance these women's lives and give them self-confidence, as well as save the taxpayers a great deal of money.

Displaced homemakers do not have high-paid, fast-talking lobbyists to act as their advocates and promote their cause. They fall between the cracks and are the forgotten victims of our society. They want to work, and they need help to reach this goal. It is up to us, as elected officials, to see to it that their needs, and the needs or their children, are addressed. I believe that the concept of my legislation, expanding the TJTC program, will do much to address the needs of these "hidden poor." This is nothing less than an issue of compassion, good fiscal sense, and progressive thinking.

Madame Chairwoman, I urge you and the other members of the select committee to consider legislation to expand the TJTC Program to include a displaced homemakers target group. As our elders have taught us, "if you give a person a fish, you feed him for a day; if you teach a person to fish, however, you feed him for a lifetime." I believe that targeting displaced homemakers under the TJTC program is the equivalent of teaching these women "to fish" and learn a skill that will last them a lifetime.

Thank you, Madame Chairwoman.

PREPARED STATEMENT OF HON. SCOTT KLUG, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF WISCONSIN

Mrs. Chairwoman, Today's Committee hearing is an important step in the journey toward changing this government's tax code to benefit families instead of throwing roadblocks in their way.

It is heartening that a bipartisan approach is being taken on this issue. We agree that families, especially the middle class, are being squeezed out of existence by tax policies that haven't changed with the times. For example, studies—this committee has reviewed figures that show dependent exemptions have dived from 40 percent of per capita personal income in 1948 to a current offset of about 11 percent. This, along with forcing lower-income families to choose between losing payments from government programs which pay more than many employers do, or preventing families from moving to find better opportunities rather than sacrificing public housing benefits have exacerbated the decline of the American family.

That is why it is essential this Committee continue to support measures like H.R. 1277, which was introduced by the Ranking Minority Member of this Select Committee, Mr. Wolf, that increases the amount of exemptions for dependent children under the age of 18 to $3,500. Most importantly, this kind of legislation allows the family to spend the money in a way that is best for that particular household without government interference.

H.R. 1277 is a good start in increasing exemptions for tax-burdened families. These exemptions should continue to increase. We should develop a plan which allows the family to make a choice about who stays home and who works. Right now the current system often forces both parents to work just to make ends meet. This bill will allow mothers and fathers to spend more time with their children.

Other measures like H.R. 34, of which I am a cosponsor, establishes tax-free education savings accounts which give families a break in providing for the education of their children. This not only gives relief to those who want to save for their children, but guarantees better-educated generations of Americans. Flexi-time and tax breaks for home-based businesses are other ideas which allow us to break down economic barriers for our families.

In today's world, strong family values serve as a valuable deterrent to delinquency and as an important guide for our children as they face a complicated and often dangerous world. Our country's families are in danger, but with a responsible tax code, we can buttress this nation's greatest strength, the American family. Thank you, Mrs. Chairwoman.

PREPARED STATEMENT OF HON. BILL BARRETT, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEBRASKA

Thank you Madam Chairwoman.

Its an honor for me to be on this Committee, especially when we are here this morning discussing a problem that every American family is facing—that being the declining family dollar.

Today's families are caught in a vise; being squeezed from one side by the Federal Government that needs more money; and from the other side, from the rising costs of raising children. Both of these pressures end up hurting the ones we want to help: the children.

As we are confronted by more than $300 billion in federal debt, we at the federal level must safeguard against tightening the vise on our families by taxing them more or otherwise reducing the power of their family dollar.

What America's families need first and foremost is the economic leverage of more disposable income—so they can afford to raise their kids, provide a good home, and save for college. What they certainly don't need is another federal program.

You know, at a recent hearing before one of my Subcommittees dealing with reauthorizing the Older Americans Act, a witness who helps run Older American Act programs said, and I'll paraphrase: That it's been his experience that "when a program has been developed to help the poor, the program has ended up being poorly run." American families can't afford to endure a poorly run program.

And so, what we need to embark upon is a national policy of putting the punch back into family economic power on our policy agenda.

But, today's families are being constrained. For example; in 1948, a family of four paid 2 percent of its income for federal taxes, today a family of four pays 24 percent; had the personal exemption tax kept pace with inflation and per capita income, it would be about $7,800 today, compared to its current level of $2,050; the Earned Income Tax Credit (EITC), the only refundable federal tax credit for families applies to only those who earned less than $20,264 in 1990.

In Nebraska, where a two-income family's per capita income was approximately $30,000, most families in Nebraska, I believe, can't qualify for EITC. And since today is the tax filing deadline for federal income taxes, I know most Nebraska parents aren't feeling they've paid too little in federal taxes.

That leaves us with the question; what can we do at the federal level to enable families greater financial freedom?

A key element to that solution, I believe, is a bill that I've cosponsored along with many on this committee, is H.R. 1277. As most of us in the Committee know, this bill proposes to increase the dependent tax deduction from $2,050 to $3,500. While this is a modest increase, its I hope, the first step forward to creating a sensible family tax policy.

I'm sure that this morning's witnesses, who are all recognized experts in tax policy as it affects America's families, will give us suggestions as to how we can best answer that question.

Thank you Madam Chairwoman.

PREPARED STATEMENT OF HON. J. DENNIS HASTERT, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF ILLINOIS

Thank you, Congresswoman Schroeder. I want to thank you for holding a hearing that focuses on the growing consensus that the time has come to enact policies that work for the American family rather than against it.

I also want to commend my distinguished colleague from Virginia, Congressman Wolf, who is leading the effort to ease the tax burden plaguing American families by introducing the "Tax Fairness for Families Act." Increasing the personal exemption for children is a critical component of an effort to make the tax code more "family-friendly."

It is only fitting that we hold this hearing on April 15, the deadline for Americans to file their annual federal income taxes. While we hear testimony today, millions of families will be dropping their tax returns in the mail, and many of them will be struggling to figure out how they are going to make ends meet in the face of a tax burden that takes away even more of their hard-earned dollars every year.

Last year I sponsored National Tax Freedom Day to highlight the fact that Americans had to work until May 5th just to pay the tax collector. And today, the Tax Foundation announced that Americans will have to work even longer—until May 8.

I am confident that these hearings will reveal a fundamental truth that many policy-makers have ignored for too long: That American families aren't paying too little in taxes—the government is simply spending too much. Once we learn how the tax burden has been increasing over the years, I believe it will be clear that controlling spending, not raising taxes on families, is the answer to our fiscal problems.

Thanks again to everyone here today, and I look forward to listening to the testimony of our distinguished guests.

Chairwoman SCHROEDER. I first want to welcome this morning a personal friend and a wonderful person, Celinda Lake, who is the Vice President of Greenberg-Lake. We are excited to have her because she is going to be summarizing recent polling data on taxpayers' feelings about taxes. So, Celinda, we are really pleased that you finished one of these polls just recently in the field and will be able to fill us in. We welcome you this morning.

The floor is yours.

STATEMENT OF CELINDA LAKE, VICE PRESIDENT, GREENBERG-LAKE, WASHINGTON, DC

Ms. LAKE. Thank you very much.

Madam Chairwoman, Members of the committee, I want to thank you very much for looking into this topic. I can tell you, Madam Chairwoman, American families are already "seeing red" over their taxes, so they are with you and they will be glad to hear that you're thinking about them.

American families have faced a decade of stagnant incomes. In the last 10 to 12 years, 80 percent of Americans have seen their real income stay the same or decline, and they know it. They express their concerns in the polls and in focus groups that they will not be able to survive. Even before the current recession, only 39 percent of Americans thought the American family was better off than it had been 10 years ago. A majority thought it was worse off.

When we asked families what will happen to them by the year 2000, they say middle-class families will disappear. There will only be the rich and the poor.

Squeezed between rising prices and higher taxes, they say that, even with two incomes, it is not enough to make it today. The American dream has always been to give your children more than you had. Yet today, families express, in our focus groups and our polls, that they fear they will not be able to give their children the same advantages that they had when they grew up.

Government has failed middle-class families and working families today. Only seven percent think that the middle class has benefited most from the Government policies of the last 10 years; only 11 percent think the poor have benefited most. Seventy-two percent think that the rich have benefited the most.

The biggest thing that Congress can do for families today is to put money back in their pockets. Families face steeply rising costs for health care, housing and education for their kids. They feel the pressures of a rising and increasingly regressive tax burden.

These feelings have become only more acute in the current recession. Unlike the recession of 1982, this recession is much more about incomes than jobs. The increase in gas prices triggered a loss of confidence by the American public and convinced families that their increasing long-term anxiety about the decline of the American economy, and the decline in families' personal economy, was justified.

Taxes are central to American families' sense of declining living standards. And you won't be surprised that most Americans don't think you're going to be able to give them a tax break. Eighty-two percent, in fact, think that Congress will deliver them a tax increase this year. Even with the declining economy, 42 percent of Americans think that an increase in their taxes is their biggest economic worry for the future. That contrasts with 24 percent who worry about increased prices, 14 percent who worry about their jobs, and 11 percent who worry about interest rates.

Even when we specifically focus on income taxes, 47 percent of American families think their income taxes are likely to go up, and middle- and working-class families expect to be hit hardest of all.

The tax reform package has failed most American families. They went in with low expectations and were even more disappointed. Americans feel that since 1986 their taxes have gone up, not down, that the system is no fairer than it used to be, and it's not even simpler to pay their taxes. Fifty-six percent of Americans found that their taxes had increased since 1986; only seven percent believe that their taxes have decreased since the tax reform bill. That includes voters of the lowest level of the income spectrum.

Fifty-seven percent of voters think that their taxes will continue to increase in the next three years significantly, and only nine percent think that they won't increase significantly in the next three years.

Of course, voters pay taxes at a number of levels, and part of the shift in taxes has been the State and local tax response to shifting burdens and "new federalism". This has increased the burden on American families because State and local governments have responded with primarily sales and property taxes. Particularly in New England and the Midwest, that same family's tax burden increased dramatically and in a regressive way.

However, even when we isolate income taxes, 43 percent of American families think they pay more income taxes, 34 percent think they pay the same, and only 14 percent think they pay less.

Now, Americans have never loved their income tax. We have data dating back to 1948—between 1948 and 1967, 45 to 60 percent of Americans thought that their income taxes were too high. Now that number is three-fourths of Americans. It has jumped significantly in the last few years.

The American public never expects to see the middle class or the American family get a tax break, and they don't believe that Congress will be able to deliver on it. But they know what they would like if they could see it. We have tested a number of different taxes and different packages. I would suggest that this data is very exploratory, but I want to give you a sense of what American families are thinking.

They like very much an IRA for education and housing. They like very, very much an increase in the exemption for families, and they are equally supportive of it, if it is graduated by bracket. They want to maintain the home mortgage deduction, which they believe is the only deduction for middle-class families. And they want to see a tax credit on their income for Social Security payroll taxes.

I will caution you that there is one proposal out there that the American public has significant reservations about, and that is the decrease in the payroll tax for Social Security. Americans worry very much about whether Social Security will be there. They would rather see a deduction in their income tax than a cut in the payroll tax. They are very clear that there are two income strains here that they are paying and want to reduce their income tax not jeopardize Social Security.

The short answer, and the way to summarize this, is that American families are well aware of what has happened to their taxes, and they are crying out for help. Congress could do nothing more substantial or more important to help middle-class and working-class families than to look at their tax burden and try to ease the regressive burden on their families.

I thank you.

[The graphs and the prepared statement of Celinda Lake follow:]

Prepared Statement of Celinda Lake, Vice President, Greenberg-Lake, Washington, DC

American families have faced a decade of stagnant incomes. In the last 10-12 years, 80 percent of Americans have seen their real incomes stay the same or decline and they know it. They express concerns in polls and focus groups that they will not be able to survive. Even before the current recession 39% think the American family is better off than it was 10 years ago—a majority think they are worse off (Newsweek). When we asked families what will happen to the middle class families by the year 2001, they said that "they will disappear"—"there will be only the rich and poor." Squeezed between rising prices and higher taxes, they say that even two incomes are not enough to make it. The American dream has always been to give your children more than you had, yet families today fear they will not be able to give their children the same benefits they had. Government has failed the middle class. Only 7% think the middle class benefitted from government—72% think the rich have benefitted the most from government (only 11% chose the poor). The biggest thing that Congress can do for families today is to put more money back in their pockets. Families face steeply increasing costs for health, housing, and education for their kids They feel the pressure of rising prices and an increasingly regressive tax burden.

These feelings have become only more acute in current recession. Unlike the recession of 1982, this recession is much more about incomes than jobs. The increase in gas prices triggered tons of confidence and worried concerns for the American public that their increasing long term anxiety about the decline of the American economy and their own family's economy was justified.

Taxes are central to American families' sense of declining living standards and 82% of Americans expect their taxes to go up. Even with the declining economy, 42% of Americans think that an increase in taxes is their biggest economic worry for the future. That contrasts with 24% worried about an increase in prices, 14% about finding a job, and 11% increase in interest rates. (Gallup, 1990). Even when they specifically focus on income taxes, 47% of Americans expect their income taxes to go up. And middle and working class families expect to be hit hardest of all.

The Tax Reform package failed most Americans families. They went in with low expectations and were even more disappointed. Americans feel that since 1986 their taxes have gone up, not down, that the system is no fairer than it used to be, and that it has not simplified paying taxes. 56% found that their taxes had increased since 1986 while only 7% think their taxes have decreased since the tax reform bill. Even those earning less $20,000 saw an increased in their tax bill. Moreover, 57% expect their tax bill to be higher yet in three years under the Tax Reform Act.

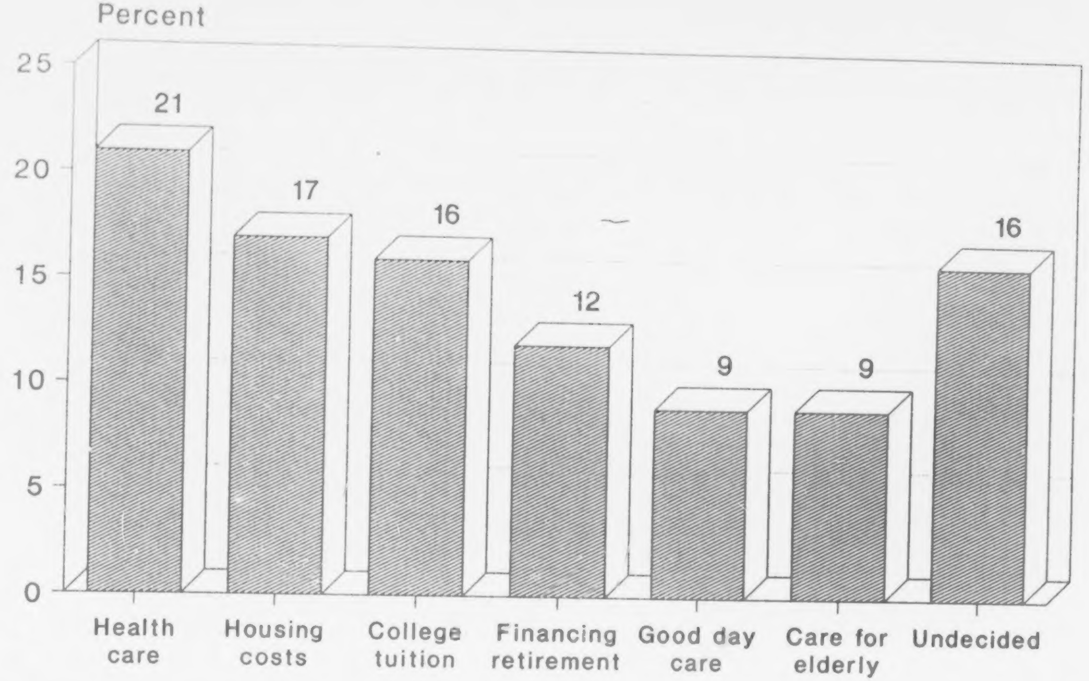
Of course voters pay taxes at a number of levels and part of the shift in taxes has been as state and local taxes have increased under the new federalism. This has increased the burden on American families with a series of more regressive taxes. Voters in the North East, Midwest and South have in particularly seen their property taxes increase, and now rate that as the most burdensome tax of all. However, even if we isolate income taxes, 43% of Americans think they are paying significantly more, 34% think they are paying the same, and 14% pay less than before. Americans have never linked their taxes. We have data over time and from 1948 to 1967 between 45% and 60% think their income taxes are too high. Now between 63-75% think these taxes are too high.

Voters never expect middle class to really see a break. However, they know what breaks they would like. We have done polling and focus groups on a number of proposals and the vast majority of voters favor an IRA for education, and housing.

There is one proposal about which voters have significant reservations and that is the Moynihan tax proposal. Voters worry about whether Social Security will survive. Will it have enough money for their parents and themselves? This is a broad-based program that enjoys enormous support and voters do not want to put it in jeopardy even for a tax break. "The thing about the Social Security that got me is that all you hear about is Social Security is not even going to be there by the time I'm old enough to retire." "Since they're running out of money you're just going to lower what they're collecting. It doesn't make sense." Voters understand that there are two income streams—their federal income tax and their payroll tax. Voters strongly prefer a payroll tax credit in their income tax.

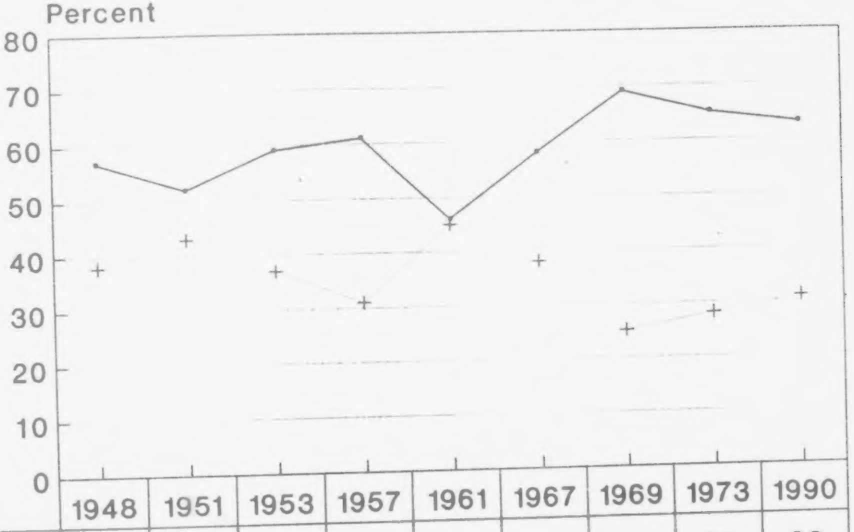
In sum, these hearings today are very important. If you are worried about how to help working in middle class, no topic is more important than their tax burden.

Chart 1: Which one of these family concerns causes you to worry most?



The Gallup Organization for
Newsweek, Oct 1-4, 1989

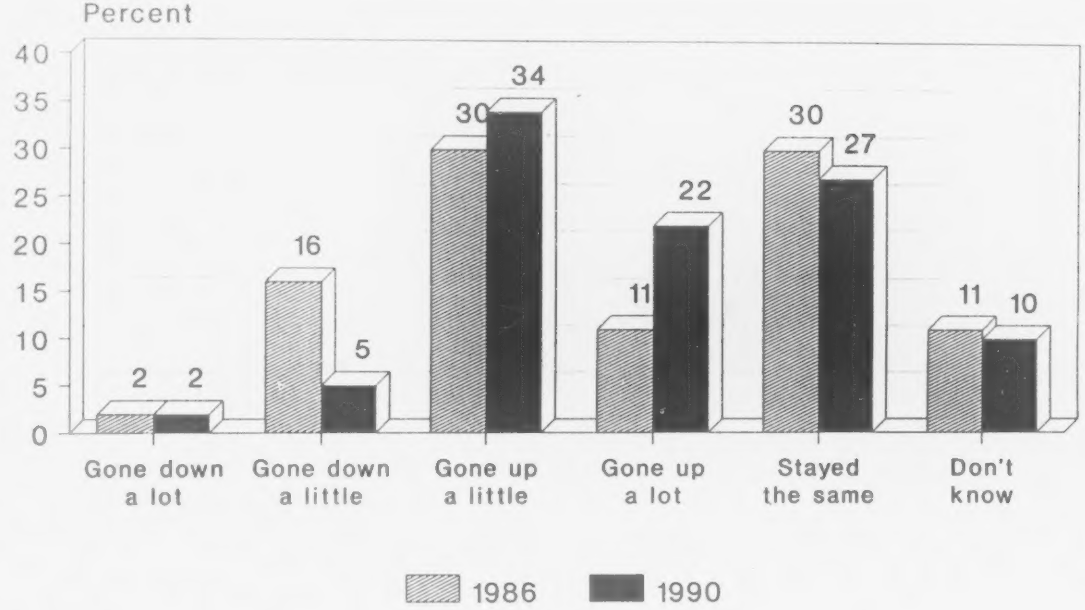
Chart 2: Do you consider the amount of federal income tax which you have to pay as too high, about right, or too low?



	1948	1951	1953	1957	1961	1967	1969	1973	1990
Too high —•—	57	52	59	61	46	58	69	65	63
About right +	38	43	37	31	45	38	25	28	31

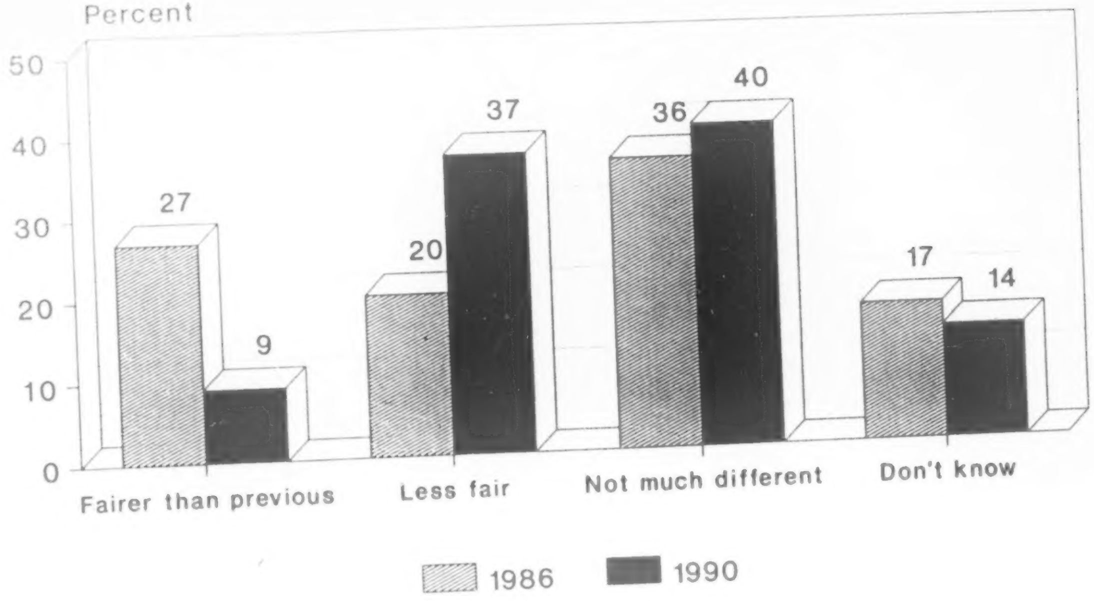
The Gallup Organization distributed
by Los Angeles Times Syndicate
March 26, 1990

Chart 3: Since the Tax Reform Act of '86 has the amount of taxes you now pay gone down, gone up, or stayed about the same?



The Gallup Organization distributed
by Los Angeles Times Syndicate
March 26, 1990

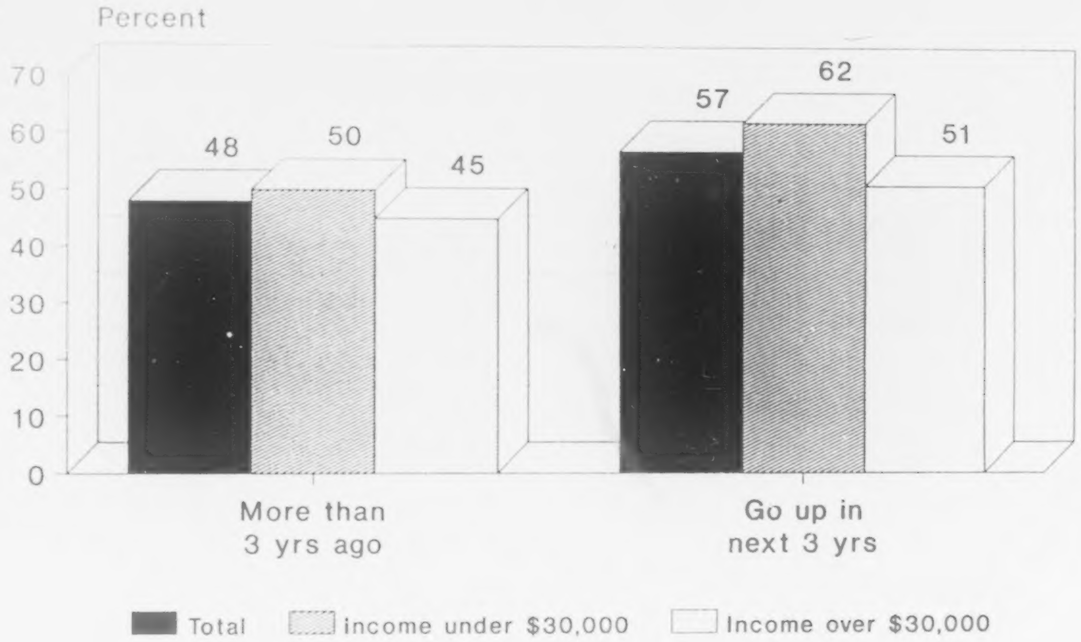
Chart 4: Do you think the Tax Reform Act has made for a fairer distribution of the tax load among all taxpayers...?



The Gallup Organization distributed
by Los Angeles Times Syndicate
March 26, 1990

Chart 5: Taxes Paid

(All types, as a proportion of income)



The Gallup Organization distributed
by Los Angeles Times Syndicate
August 30, 1990

Chairwoman SCHROEDER. Thank you, Celinda. That's very helpful. And we appreciate the charts and graphs that you have given us.

It's wonderful to know that the taxpayers are aware of this. Maybe if they're aware of it, and we really start focusing on it, we can get something done.

Congressman Wolf, do you have any questions?

Mr. WOLF. No, I have no questions.

Chairwoman SCHROEDER. Does anybody else have questions? Congresswoman Horn.

Ms. HORN. Celinda, at the end of your statement you mentioned some data showing that families would prefer a credit for FICA rather than a rollback because of insecurity about the Social Security system.

Ms. LAKE. Right.

Ms. HORN. Is that based on polling data? It is a very complex issue. Did your focus groups find this information?

Ms. LAKE. Voters are unsure in the polling data. What they are sure about is that they would like a tax credit. They are unsure in the polling data—and you're right, Congresswoman, that the numbers bounce around, depending on how the package is explained.

In focus groups they have been very clear about it. The American public feels very strongly that Social Security won't be there when the next generation retires. They think of it as a pool of money that is actually short of money, so they think it doesn't make sense to take money away from the one pool of money that they can count on.

They also see it as one of the few broad-based programs out there, so they want to preserve, not endanger, one of the few programs that they still see as for them.

Ms. HORN. Okay. That's helpful. Thank you.

Chairwoman SCHROEDER. Thank you.

Congressman Camp, any questions?

Mr. CAMP. No, Madam Chairwoman.

Chairwoman SCHROEDER. Congressman Barrett?

Mr. BARRETT. No thank you.

Chairwoman SCHROEDER. Thank you very much, Celinda. We really appreciate that overview.

Now we've got a great visual. We have a panel of six from all different ends of the political spectrum, and we're very pleased that they are all coming to the table to talk to us about taxes, because we think this may be the only good news there is for America's families on April 15th.

First we have Eugene Steuerle, who is a Senior Fellow at the Urban Institute in Washington, D.C. We have Robert Shapiro, Vice President of the Progressive Policy Institute in Washington. Gary Bauer, President of the Family Research Council in Washington; Timothy Smeeding, project director of the Luxembourg Income Study; Heidi Brennan, who is Co-Executive Director of Mothers at Home, Vienna, VA; and Nancy Duff Campbell, who is the managing attorney of the National Women's Law Center.

I think we have six chairs up there, so if you could all move to the table. Let me tell you that both the ranking member and myself were very honored to have this distinguished panel which does cut across all spectrums in talking about taxes.

We welcome all of you. We will put all of your statements in the record. Feel free to summarize or tell us whatever it is you think we need to know. Dr. Steuerle, let's start with you, if you don't mind. We'll give you the microphone first.

STATEMENT OF C. EUGENE STEUERLE, PH.D., SENIOR FELLOW, THE URBAN INSTITUTE, WASHINGTON, DC

Dr. STEUERLE. Thank you.

I am pleased to be here today to comment on changes in the tax code and their impact on families. I am especially appreciative Chairwoman Schroeder, of your efforts, and Mr. Wolf's and those of other Members of the committee, in studying this vital issue.

Let me note from the start that many of the changes I will discuss seem not to be the result of deliberate action but, really, are a consequence of inattention to the ways in which the Nation's tax and welfare systems have been evolving. This inattention, by the way, occurred in both Democratic and Republican administrations, in good times and in bad, and was reversed only slightly in the Tax Reform Act of 1986. A particular neglect was the lack of integration of the tax and welfare systems, leaving some households with children, particularly people in the lower- and middle-income ranges, to fall between the cracks of the two systems.

Over the past few decades, the tax system has required that households with children bear a larger proportion of the total tax burden. As you have already indicated, Madam Chairperson, the dependent exemption as a percent of personal income between 1948 and 1990 declined significantly. In 1948, the personal exemption or the dependent exemption was set at $600 per person, which was well in excess of 40 percent of per capita personal income. By 1990, this exemption was only $2,050 per person, or about 11 percent of per capita personal income. If we had indexed this exemption for inflation as well as growth and real per capita income, in 1990 it would have been about $7,800, rather than $2,050.

Now, an exemption reduces income subject to tax. If we were to calculate the value of such an exemption, we would find that the value of the exemption—sometimes called the credit equivalent amount—could also have been indexed for growth and per capita income. Then a minimum tax reduction of almost $1,300 in 1990 would have been provided for each additional child of the taxpayer. Today, however, we provide much less of an adjustment for the children of a taxpayer.

Therefore, even with a significant increase in the tax adjustment—either through a tax credit or an increase in the dependent exemption—at each income level households with dependents would still pay a larger share of the total tax burden, and households without children a smaller share of the total tax burden, than we had in previous years.

This decline in the value of the personal and dependent exemptions for Federal income tax purposes, by the way, is matched by a similar decline in value for State and local income tax purposes.

In 1950, a family of four with wage income at about one-half the median income for that size family—that is, a fairly modest income family—would have paid no income tax at either the Federal or State levels. Today the income tax burden would be in excess of five-and-a-half percent at the Federal level and two to three percent of income at the State level.

Partial restoration of this income tax adjustment would not even account for the large Social Security tax increases that have also been faced mainly by households in their child-rearing years. Social Security taxes are, by far, the principal tax on earnings for a majority of workers.

Combined Social Security tax rates have risen from 2.0 percent of earnings in 1948 to 15.3 percent of earnings today. At very low income levels, these increases in Social Security and income taxes have been offset in recent years by expansions in the Earned Income Tax Credit. The Earned Income Tax Credit, however, phases out fairly rapidly as income increases. At incomes of one-half the median income of a four-person family—that is about $21,500 today—no earned income credit is available.

To make the contrast more startling, we might note that families with cash income at that level, that is, about $21,500, paid only about two percent of their income in Federal and State income taxes and Federal Social Security taxes in 1948. Today they pay about 23 percent of their income, or almost $5,000.

It is important to realize that for low-income individuals the most important taxes are not always in the direct tax system. Instead, a variety of benefits—AFDC, food stamps, Medicaid and the Earned Income Tax Credit—are taxed away or phased out at a fairly rapid rate as income increases.

Traditionally, there are three ways in which low-income individuals have been able to make a better life for themselves. They move, they work, or they marry. The welfare and tax systems together impose extraordinary penalties for any of these actions.

In the interest of time, I will speak only to the work and the marriage disincentives.

For those of you who have my testimony, in Figure 3 Jason Jefferies and I show how a typical AFDC recipient with two children is assumed to receive average AFDC benefits, average food stamps, and a typical Medicaid package. The example doesn't even treat additional sources of assistance, such as housing assistance.

In the first example, we note what happens when this person decides to work at a minimum wage job of about $8,500 a year. Mainly, because public benefits are reduced or eliminated as earnings rise, the household income goes up hardly at all. The effective tax rate—defined as the percent of total earnings that are offset by decreased welfare benefits, increased taxes, and additional costs of working—is over 90 percent in this example. The rate would be well in excess of 100 percent if we had assumed any of the following: higher welfare benefits, a more expensive cost of health insurance, or even minor child care costs. The bottom line is simple: under the current welfare and tax systems together, many welfare recipients are paid not to work, they are paid not to work at minimum wage.

Even for a welfare recipient who moves from welfare to a job paying $15,000 a year, including employer-provided medical insurance, would find that income goes up modestly. In another example we show the effective tax rate faced by this person is equal to almost three-fifths of total earnings.

Perhaps even less recognized than the penalties for work within the welfare system are the penalties for marriage. In almost all cases under current law, a low-income welfare recipient and a potential working spouse who marry must pay a substantial penalty of several thousand dollars. Low-income couples who choose marriage simultaneously are forced to choose a much worse economic life for their children—a true moral, as well as economic, dilemma.

Again for those of you who have my testimony, Figure 4 shows some of these marriage penalties. First, let's take a welfare recipient who marries a spouse earning the minimum wage and has no health insurance from an employer. By marrying, their combined income would be reduced by over $4,600, or about 30 percent of their former combined incomes of over $15,000. Alternatively, suppose the welfare recipient wants to marry someone who earns $15,000 annually and is lucky enough to receive health benefits from an employer. Their combined income from marriage decreases by about $3,600, again a decline of 17 percent.

How do these marriage penalties arise? Almost all tax and welfare programs have been designed to provide assistance at the very lowest income levels. This assistance is reduced or phrased out at a rapid rate as income increases. Therefore, it is better to stay unmarried than to marry someone with even a modest income.

In summary, by far the two most significant changes in the tax system over the past few decades have been the increase in Social Security tax rates and the decline in the value of the personal and dependent exemptions. These changes have had their most dramatic impact on working families with children, those who were most likely to pay Social Security taxes and make use of dependent exemptions.

The taxing away of benefits in welfare programs and the earned income tax credit, when combined with the tax rates in the direct tax system, has created a situation where low-income individuals on welfare—again, usually households with children—pay tremendous penalties for engaging in behavior that is most likely to make a better life for themselves: to work, to marry, or to move.

I do not want to mislead anyone. These problems have arisen over several decades and are related to shifts of hundreds of billions of dollars in our tax and welfare systems. Even a reform as significant as the Tax Reform Act of 1986 made only a moderate, one-time reversal in the decline in the relative value of the personal exemption.

Redressing the situation, therefore, could involve significant sums of money and large shifts in tax burdens and transfer payments. It must be thought of as a multi-year, perhaps even a multidecade effort. At the same time, I would not suggest a solution that involved increasing today's deficit or raising Social Security tax rates even more in the future.

Although elsewhere I have advocated the adoption of a refundable tax credit for children as a replacement for the dependent exemption and for a significant portion of AFDC, my principal concern is that all of us together begin to act in an integrated fashion with respect to our myriad tax and welfare programs and consider especially the situation of low- and moderate-income workers with children.

Thank you.

[Prepared statement of C. Eugene Steuerle follows:]

PREPARED STATEMENT OF C. EUGENE STEUERLE, PH.D., SENIOR FELLOW, THE URBAN INSTITUTE, WASHINGTON, DC

Much of this testimony is taken from research performed with Jason Juffras of The Urban Institute and Paul Wilson of Carlton College.

Any opinions expressed herein are solely the author's and should not be attributed to The Urban Institute, its officers or funders.

Chairwoman Schroeder and Members of the Committee:

You have asked me to comment on changes in the Tax Code and their impact on families. Let me note from the start that many of the changes in the taxation of families since World War II seem not to be the result of deliberate action, but rather a consequence of inattention to the way in which the nation's tax and welfare systems have been evolving. This inattention occurred in both Democratic and Republican administrations, in good times and in bad, and was reversed only slightly in the Tax Reform Act of 1986. A particular neglect was the lack of integration of the tax and welfare systems--leaving some households with children to fall between the cracks of the two systems and causing other households to face declines in well-being when they moved off welfare and onto the income tax rolls.

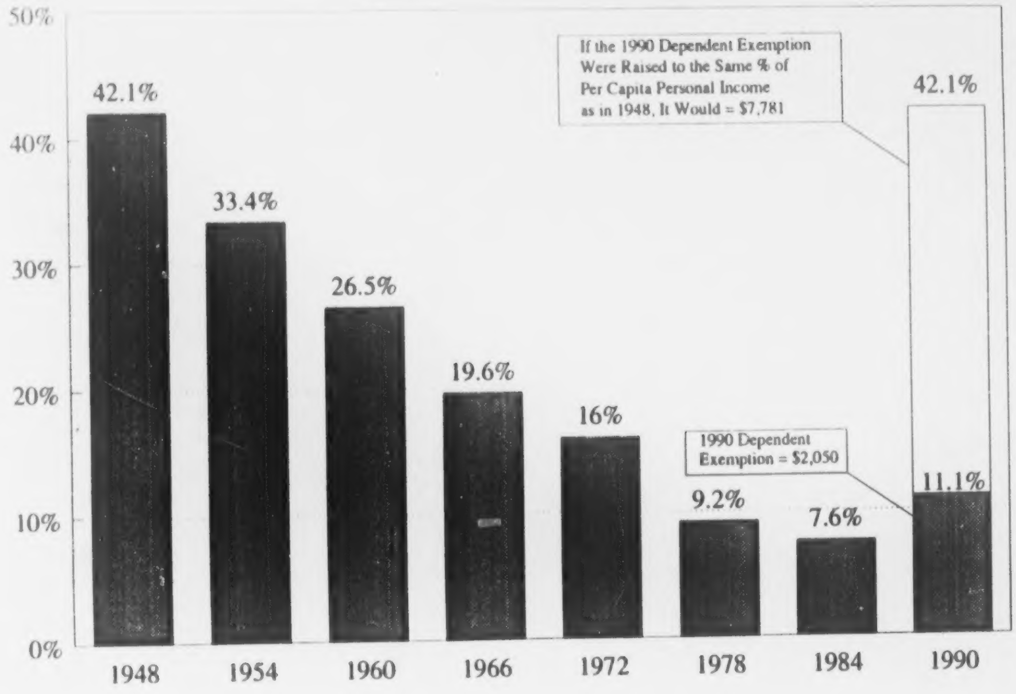
A. THE TAX ISSUES

Over the past few decades, the tax system has required that households with children bear a larger proportion of the total tax burden. This trend was due first to the failure to increase the dependent and personal exemptions in step with rises in individual income.

In 1948 the personal or dependent exemption was set at $600 per person, or well in excess of 40 percent of per capita personal income. By 1990, this exemption was only $2,050 per person, or about 11 percent of per capita personal income. If the personal exemption had been indexed for growth in inflation and real per capita income, in 1990 it would have been about $7,800 rather than $2,050 (see Figure 1).

Figure 1

Dependent Exemption as a Percent of
Per Capita Personal Income, 1948-1990



SOURCE: C. Eugene Steuerle and Jason Juffras, The Urban Institute, Washington D.C.

An exemption reduces income subject to tax. For most taxpayers who were in the lowest tax bracket in 1948, the $600 exemption was worth $100. For instance, a typical taxpayer with two children would have paid about $200 less in income tax because of the additional $1,200 in dependent exemptions. Suppose the $100 value of the exemption--sometimes called the credit-equivalent amount--had been indexed for growth in per capita personal income. Then a minimum tax reduction of $1,290 in 1990 would have been provided for each additional child of the taxpayer (see Figure 2). The amount would have been greater for higher-income taxpayers.

For most taxpayers with children, therefore, a child tax credit even in excess of $1,000 would not restore the relative importance of a tax adjustment that had been allowed over four decades ago. Even with a significant increase in the tax adjustment--either through a tax credit or an increase in the dependent exemption--at each income level households with dependents would still pay a larger share of the total tax burden, and households without dependents a smaller share of the total tax burden, than in previous years.

This decline in the value of the personal and dependent exemptions for federal income tax purposes, by the way, was matched by a similar decline in value for state and local income tax purposes.

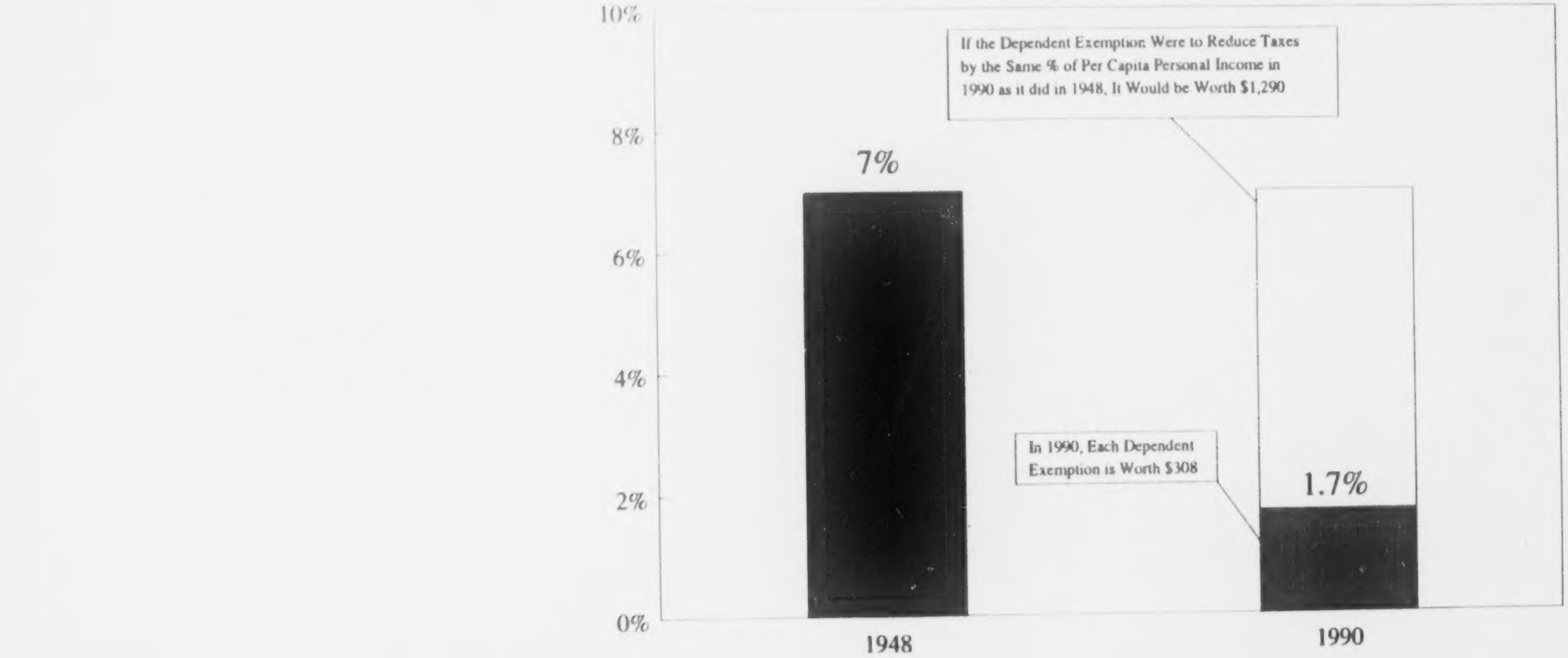
In 1950, a family of four with cash wage income at one-half the median income for that size family would owe no income tax at either the federal or state levels. Today the income tax burden would be in excess of 5 1/2 percent of income at the federal level and between 2 and 3 percent of income for state income tax purposes.

Partial restoration of the income tax adjustment would not even account for the large Social Security tax increases that have been faced by households mainly in their child-rearing years. Social Security taxes are by far the principal tax on earnings for a majority of workers.

Figure 2

Amount of Tax Reduction Provided by Each Dependent Exemption, as a Percent of Per Capita Personal Income

1948 & 1990 *



* Minimum amount of tax reduction for those with positive tax liability, i.e., the value of each dependent exemption at the lowest positive tax rate (15% in 1990).

SOURCE: C. Eugene Steuerle and Jason Juffras, The Urban Institute, Washington D.C.

Although the tax is assessed on both employers and employees, most economists would argue that the worker bears all or almost all of the burden of the tax. Combined Social Security tax rates have risen from 2.0 percent of earnings in 1948 to 15.3 percent of earnings today (3.0 percent in 1950, 6.0 percent in 1960, 9.6 percent in 1970, 12.26 percent in 1980, and 15.3 percent in 1990). The rate of increase was almost constant at 3 percentage points per decade in the years from 1950 to 1990.

At very low income levels, these increases in Social Security and income taxes have been offset in recent years by expansions of the earned income tax credit (EITC). The EITC, however, phases out fairly rapidly as income increases. Even after the EITC expansions of the 1990 budget agreement are fully implemented, the offset will be incomplete for families with incomes as low as $12,000. At an income level of just above $20,000 ($20,264), no earned income tax credit at all is available.

How do these various tax increases add up? Families of four with cash income of one-half the median income for that size family--about $21,500 in 1990--paid only about 2.0 percent of their income in total federal income taxes, state income taxes, and federal Social Security taxes in 1948, versus about 23 percent of their income today. This tax burden of almost $5,000 for a working family of four at one-half median income can also be contrasted with an income and Social Security tax burden of close to zero for couple over age 65 with no dependents and with about the same income, including average Social Security benefits.

B. INTEGRATION OF THE TAX AND WELFARE SYSTEMS

It is important to realize that for low- to moderate-income individuals who are moving or have moved just beyond the welfare system, the most important taxes are not always in the direct tax system. Instead, a variety of benefits--AFDC, Food Stamps, Medicaid, and the Earned Income Tax Credit--are taxed away or phased out at a rapid rate as income increases.

Traditionally, there are three ways in which low-income individuals have been able to make a better life for themselves. They move, they work, or they marry. The welfare and tax systems together impose extraordinary penalties for any of these actions.

Don't Move! Americans have long moved from location to location in search of a better job or environment. The welfare system, however, provides strong disincentives to move in search of a job, better education for one's children, or a location closer to child care from one's parents.

One deterrent to mobility is that some benefits are not portable. Perhaps the worst example is public housing, with its limited number of slots. Once in, individuals move only at their own peril. AFDC benefits, however, also vary from State to State. Simply to reclaim those benefits after moving requires the ability to engage a new welfare bureaucracy.

Some proposals to reform the welfare and tax systems are designed so that resources available to children would not be dependent upon whether the parents moved or not. Federal child tax credits would be available in any jurisdiction, while proponents of a child support assurance favor withholding a fixed percentage of income from the absent parent and guaranteeing a minimum payment to all custodial parents regardless of where they live. Portable benefits like these avoid penalizing low-income persons who feel that they can better their situation by moving elsewhere.

Don't Work! Despite recent reforms, AFDC is still an income maintenance program instead of one that orients people toward work. Some examples help clarify how penalties for work add up in the current unintegrated tax and welfare system existing today.

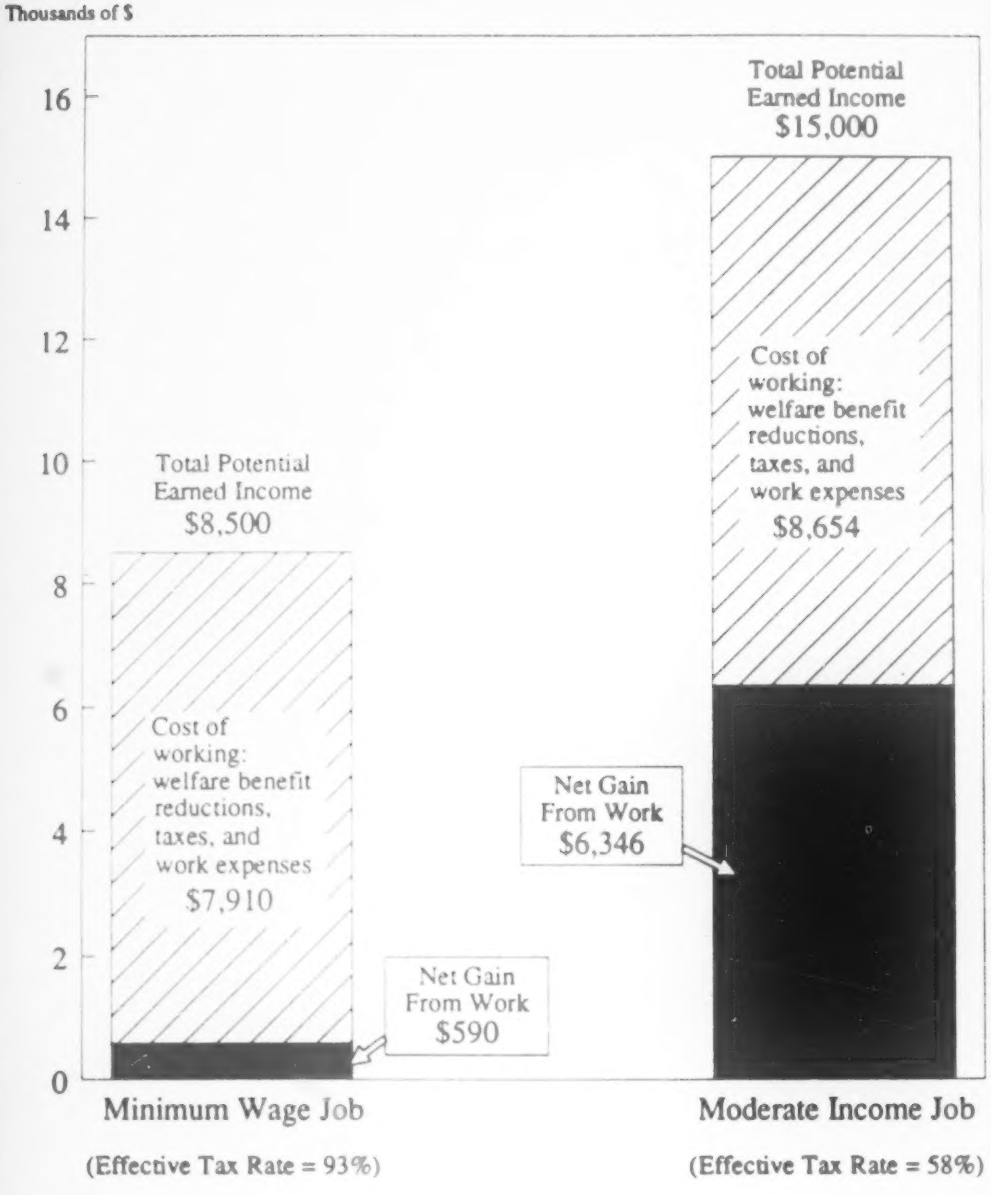
In Figure 3, a typical AFDC recipient with two children is assumed to receive average AFDC benefits, average Food Stamps, and a typical Medicaid package (the example doesn't even treat additional sources of aid, such as housing assistance). Note in the first example what happens when this person decides to work at a minimum wage job of about $8,500 a year: mainly because these public benefits are reduced or eliminated as earnings rise, the household income goes up hardly at all. The effective tax rate--defined as the percent of total earnings that are offset by decreased welfare benefits, increased taxes, and additional costs of working--is over 90 percent in this example. The rate would be well in excess of 100 percent if we had assumed any of the following: higher welfare benefits, a more expensive cost of health insurance, or more than minor child-care costs. The bottom line is simple: under the current welfare and tax system, many welfare recipients are paid not to work full-time at the minimum wage.

Even the welfare recipient who moves from welfare to a job paying $15,000 a year, plus employer-provided medical insurance, would find that income goes up only modestly. The effective tax rate faced by this person is equal to about three-fifths of total earnings.

Proposals that establish more universal benefits for children avoid these large work disincentives. For instance, a universal child credit would work much like public education: by not phasing out at higher income levels, there is no additional penalty imposed on the parent who decides to work.

Figure 3

Work Disincentive for a Single Parent on Welfare With Two Children, Under Current Law



SOURCE: C. Eugene Steuerle and Jason Juffras, The Urban Institute, Washington D.C.

Don't Marry! Perhaps even less recognized than the penalties for work within the welfare system are the penalties for marriage. In almost all cases under current law, a low-income welfare recipient and a potential working spouse who marry must pay a substantial penalty of several thousand dollars. Low-income couples who choose marriage simultaneously are forced to choose a much worse economic life for their children--a true moral, as well as economic, dilemma.

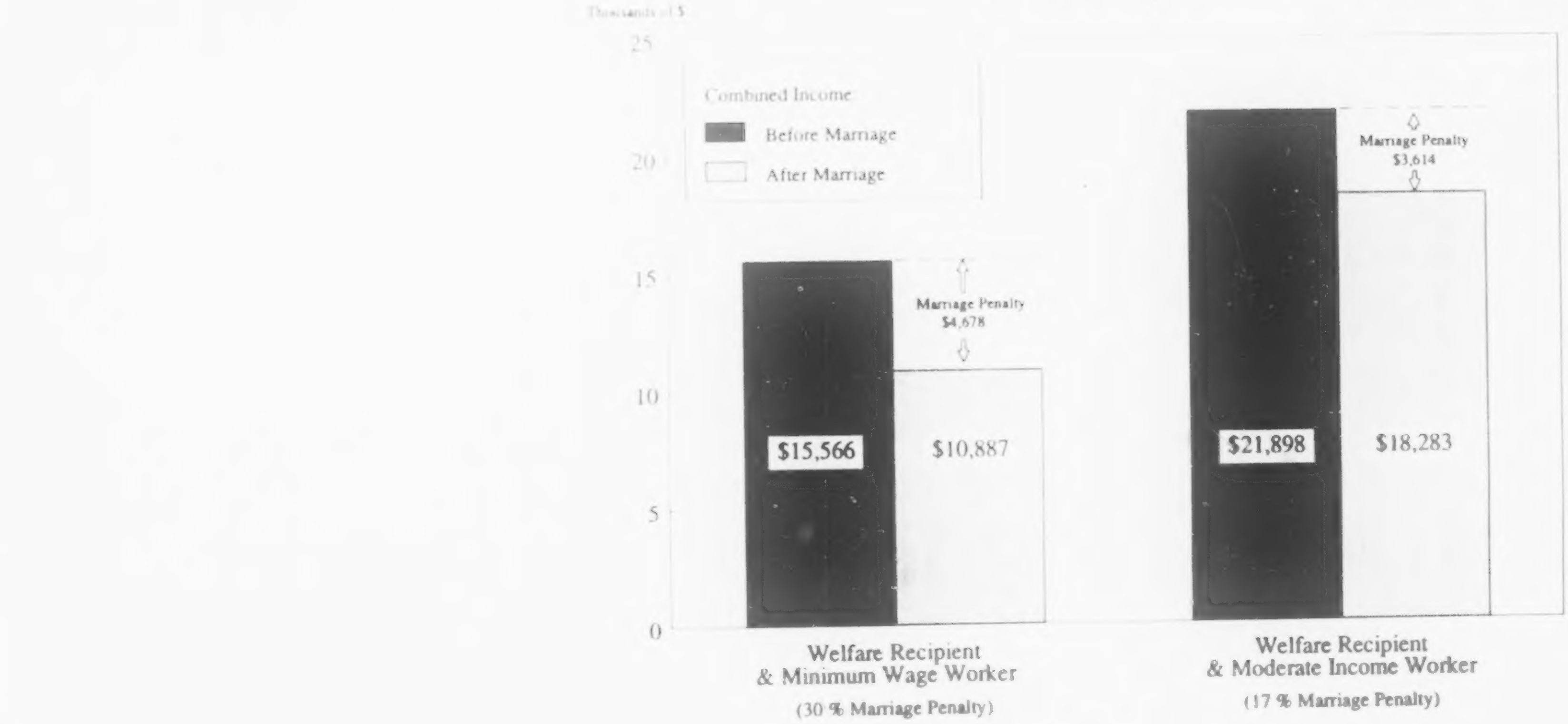
Figure 4 shows some of these marriage penalties. First, take a welfare recipient who marries a spouse earning the minimum wage (with no health insurance from an employer). Their combined income would be reduced by $4,678 or 30 percent of their former combined income of $15,566. Alternatively, suppose the welfare recipient wants to marry someone who earns $15,000 annually and is lucky enough to receive health benefits from an employer. Their combined income from marriage decreases by over $3,614--a decline of 17 percent.

How do these marriage penalties arise? Almost all tax and welfare programs have been designed to provide assistance at the very lowest income levels. The assistance is reduced or phased out at a rapid rate as income increases. Therefore, it is better to stay unmarried than to marry someone with even modest income.

Some proposals add to the marriage penalties already present in the law, some subtract, and some have mixed effects. Higher AFDC payments usually add. Expansion of earned income tax credits usually adds to marriage penalties when both spouses work, but usually reduces the marriage penalty for a nonworking welfare parent. Child tax credits and child support assurance payments can reduce the marriage penalty substantially when they substitute for AFDC or other "high-penalty" programs. They achieve this gain by making the level of benefit

Figure 4

Marriage Penalty for a Single Head of Household on Welfare and a Potential Spouse



SOURCE: C. Eugene Steuerle and Jason Juffras, The Urban Institute, Washington D.C.

or increased enforcement of child support by absent parents unconditional upon the income that might be added through marriage.

C. CONCLUSION

By far the two most significant changes in the direct tax system over the past few decades have been the increase in Social Security tax rates and the decline in the value of the personal and dependent exemptions. These changes have had their most dramatic impact on working families with children--those who were most likely to pay Social Security taxes and make use of dependent exemptions.

The taxing away of benefits in welfare programs and the EITC, when combined with the tax rates in the direct tax system, has also created a situation where low-income individuals on welfare--again, usually households with children--pay extraordinarily high tax rates for engaging in behavior that is most likely to make a better life for themselves: move, work, or marry.

I do not want to mislead anyone. These problems have arisen over several decades and are related to shifts of hundreds of billions of dollars in our tax and welfare systems. Even a reform as significant as the Tax Reform Act of 1986 made only a moderate one-time reversal in the decline in the relative value of the personal exemption.

Redressing the situation, therefore, could itself involve significant sums of money and large shifts in tax burdens and transfer payments. It must be thought of as a multi-year, perhaps multi-decade, effort. At the same time, I would not suggest a solution that involved increasing today's deficit or raising Social Security tax rates even more in the future. Although I have advocated the adoption of a refundable credit for children as a replacement for the dependent exemption and a significant portion of AFDC, my principal concern is that we begin to act in an integrated fashion with respect to our myriad tax and welfare programs and consider especially the situation in which we have placed low- and moderate-income workers with children.

Chairwoman SCHROEDER. Thank you very much, Dr. Steuerle.

I think we now know why families at the end of the year feel like the hamster in the wheel, running and running and running, tongue hanging out, and never getting out of the bottom of the wheel. So I think you did a very good job of pointing all that out.

Dr. Shapiro, we welcome you. We will put your entire statement in the record and the floor is yours.

STATEMENT OF ROBERT J. SHAPIRO, PH.D., VICE PRESIDENT, PROGRESSIVE POLICY INSTITUTE, WASHINGTON, DC

Dr. SHAPIRO. Thank you, Madam Chairwoman.

The serious effort of evaluating the best way to tax American families has to begin with the real economic life of families, and the fundamental economic fact today is that much of the American dream is beyond the reach of average working families, especially younger families.

For the last generation, while the total real wealth of the country was increasing by half, the median family income, also adjusted for inflation, failed to rise at all. More disturbing still, the real average wage for the 80 percent of the work force called nonsupervisory, everyone but professionals and managers, fell by 16 percent since 1973.

There is no modern precedent for wages falling persistently while production expands, but the explanation is reasonably clear. The economy grew because more people were working, especially more women, more mothers, and more immigrants, and because more people were working longer hours, especially women and mothers. But the additional workers and extra hours were not enough to boost by much the average family income because productivity gains were so small.

Now, before we rush to restructure the economy, it is important to remember just what these statistics represent. The median income and average wage are lines drawn through the data. As most individuals grow older, they move from below that line to above it, and most Americans earn higher wages and more income today than they did 17 years ago. But these income increases have been very small, two-thirds off the pace for the preceding period 1959-1973. As a result, the country's mediocre economic performance has most seriously affected people who got their first jobs after productivity slowed in the early 1970s.

Let's restate this. An important reason for the increase in the numbers of young children living under stressful economic circumstances is that relatively young people, the people who parent young children, have lost economic ground or have barely kept up. The average income for families headed by 15-24 year olds—which includes the age of the parents of most eldest children—adjusted for inflation, was more than eight percent less in 1987 than it was in 1973. Moreover, a generation of small income gains has left almost all families subject to more economic stress, and again, especially younger families.

The costs of the middle-class American dream—a private home, an average priced car, out-of-pocket health care expenses and college education for children—now outstrip the earning capacity of the average working family. Perversely, Government has increased the pressures on working families by raising their tax burden. Combining State and local taxes and the Federal tax paid directly by workers—that is, the income tax and the employee's side of the Social Security tax—a typical family today pays out about 25 percent of its income in taxes, as compared to 14 percent in 1960.

Moreover, changes in the tax code in the 1980s have focused more of the total tax burden on average income families and less on very affluent Americans. The principal force has been the seven increases in the 1980s in the payroll tax rate. And remember, this is a tax that applies only to wages and salaries, which account for virtually all of an average family's income, but for less than half the income of very affluent families. The cap on wages and salaries subject to the tax, $53,400 this year, covers all of the median family's income but less than one-fourth of the total income of a typical family in the top five percent.

Of all aspects of family policy, reducing the tax burden is the most straightforward. Today, the United States stands alone among the world's 18 advanced democracies in not providing any form of family allowance or government subsidy per child. We, too, should be willing to actively support the social value of nurturance. The first principle of a pro-family tax policy should be that government does not tax away income needed to support children, and this principle could be implemented by increasing the current Federal income tax exemption for children to reflect the actual cost of raising a child today, or some $5,500 to $7,000 per child.

Applied across the board, this would cost more than $40 billion in foregone revenues, but for less than $10 billion, an important beginning can be made by expanding the exemption, first for children under age 4, or under age 6, and by phasing out the larger benefit at higher incomes, beginning the phaseout at double the median income, or $70,000.

A pro-family tax policy should also recognize the profound problems of working-poor families who gain no support from a larger children's exemption because they owe no income taxes. For them, the earned income tax credit wage supplement should be expanded to ensure that anyone who works full time, year round, has enough income to support a family above the poverty line.

In addition, single parents should be granted the income tax filing status of married couples, instead of their current classification as "heads of households," which carries a tax rate lower than that for singles but higher than that for married couples. The tax liability of single parents should reflect the burdens they share with other families, not the personal fact that they are without spouses.

Finally, the economic squeeze on families could be eased further by reforming Social Security taxes, the fastest-growing part of the tax burden for all families but the very affluent.

Last year, the Progressive Policy Institute developed a plan for reducing the payroll tax burden on average people without affecting the Social Security Trust Fund or expanding the deficit. The plan is to raise the same revenues for the Trust fund by applying a lower tax rate to a larger tax base, as the 1986 tax reforms did for the income tax. And the fair and efficient way of doing this is to remove the cap that exempts from the tax all wages over $53,400 and use the additional revenues to cut the rate. This progressive reform would cut the payroll tax rate by a half-percentage point, enough to increase an average income family's take-home pay by $260, and finance it with a dose of tax equity in which the five percent most highly paid Americans, like everyone else, would pay Social Security tax on all of their wages.

I think everyone in this room, and certainly the members of the panel, agree that it is time for Congress to step forward, with or without the administration, to ease the economic stress on the Nation's families. I salute your efforts to explore the best ways of doing so.

[Prepared statement of Robert J. Shapiro follows:]

PREPARED STATEMENT OF ROBERT J. SHAPIRO, VICE PRESIDENT, PROGRESSIVE POLICY INSTITUTE, WASHINGTON, DC

PRO-FAMILY TAX POLICY: PRINCIPLES AND PROPOSALS

The Economic Conditions of American Families

The serious effort of reevaluating the proper way to tax America's families should begin with real economic life. And the fundamental economic fact in family life today is that economic growth and income gains have been so slow for the past two decades, that today much of the middle-class American dream had moved beyond the reach of average working families, especially younger families.

Two decades ago, we thought that real economic stress was a basic fact of life mainly for poor, minority, single-parent families. Today, working families, too, live with meaningful stress, economic and otherwise. In most two-parent families, both parents work and still struggle; and one-parent families, with the difficult problems they often present for children, struggle more.

We do not know how to preserve or to create two-parent families. What we can do is relieve some of the economic pressures on all moderate and middle-class families, starting with tax policy.

For the last generation, the economy as a whole performed adequately, but most of the families and workers that comprise it barely got by. From 1973 to 1989, the wealth of the country increased by about half, after adjusting for inflation; and on a *per capita* basis, the nation's real income grew by one-third. Yet the median family's income, adjusted for inflation, didn't rise at all. Even the *average* family income, which better reflects the large gains made by affluent people in the 1980s, grew by barely one percent a year -- two-thirds off the pace for the comparable preceding period, 1959 to 1973. More disturbing still, the real average wage for the 80 percent of the American work force called "non-supervisory" -- just about everyone but professionals and managers -- fell by 16 percent since 1973, including declines in five of the seven years of the 1983-89 expansion.

There is no modern precedent for wages falling persistently while production expands, but most explanations point to the concurrent slowdown in productivity. As a whole and on a *per capita* basis, the U.S. economy grew because more people were working, especially more women, more mothers and more immigrants, and because more people were working longer hours, especially women and mothers. But the additional workers and extra hours were not enough to boost by much the average family income, because the economy's productivity gains were marginal throughout the period. Combine slow productivity growth with big increases in the work force, and the result is a declining average, real weekly wage. Even counting the increased value of wage supplements, mainly health insurance and employers' contributions to social security, working Americans on average were barely better off at the end of a week in 1989 than they were in 1973.

Before rushing to restructure the economy, it is important to understand just what the statistics on median income and average wages represent, and what they do not. A median and an average are lines drawn through the data. As an individual person grows older, she or he typically moves from below that line to above it, and most individual Americans earn higher wages and more income today than they did 17 years ago. But these wage and income increases have been much smaller than most people expected, judging by the record of their parents' generation. As a result, the country's mediocre economic performance most seriously affects people who got their first jobs after growth and productivity slowed down in the early-1970s.

Whatever the complex reasons for this demographic distribution of the costs of slow productivity growth, one effect is clear: An important reason for the increase in the numbers of young children living in stressful economic circumstances is that many relatively young people -- the people who parent young children -- have lost economic ground or barely kept up. The average income of families headed by 15-to-24 year olds, adjusted for inflation, was more than 8 percent less in 1987 than in 1973, as compared to a 2.4 percent increase in the real average income of families headed by 25-to-34 year olds.

What Happened to the American Dream?

Without impoverishing most Americans, a generation of small income gains has left all families but the very affluent subject to increasing economic stress, especially younger families. The cost of achieving the middle-class American dream -- a private house, an average-priced car, health care, and college education for children -- has outstripped the earnings capacity of the average working family. Home ownership presents the greatest difficulty. Frank Levy, a careful scholar of family income developments, calculates that the payments on a typical house in the 1950s cost 14 percent of an average 30-year-old American's gross income; by the mid-1980s a median-priced house would have claimed 44 percent of the gross income of an average 30-year old.[1]

The costs of owning and operating a car, sending a child to college, and covering out-of-pocket medical expenses all take more of a typical family's income today than ever before. In 1970, an average-priced car cost the equivalent of 35 percent of the median family income; today, it comes to 48 percent, and just covering car payments, insurance and upkeep takes almost 9 percent of an average family's annual income. Similarly, a year at a private college in 1970 came to less than 28 percent of the median family income; today the figure is 38 percent, and less financial assistance is available to working parents. And since 1980, the share of a typical family's income absorbed by out-of-pocket medical expenses rose from 4.7 percent to 5.6 percent.[3]

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[1] *Dollars and Dreams, The Changing American Income Distribution*, Russell Sage Foundation, New York:: 1987.

Given the enormous significance of the American dream in our country's cultural and economic life, one could expect the government to respond; in fact, government increased the pressures on working families by raising their tax burden. Combining state and local taxes, the federal income tax, and the social security taxes paid directly by workers, the typical family today pays out about 25 percent of its income in taxes, as compared to 23 percent in 1970 and only 14 percent in 1960.

Moreover, changes in the tax code in the 1980s in particular have focused more of the total tax burden on average families, and less on very affluent Americans. The principal factor has been the sharp rise in the payroll tax, which more than offset cuts in income tax rates for everyone but the well-to-do. During the 1980s, the social security tax rate was increased seven times; and while virtually all of the income earned by an average family has been subject to this tax, only a small share of a wealthy person's income is similarly taxable. First, the tax applies only to wages and salaries, which account for virtually all of an average family's income but for less than half of the income of very affluent families. And second, the cap on wages and salaries subject to the payroll tax -- $53,400 this year -- covers all of a median family's income, but less than one-fourth of the total income of a typical family in the top five percent.

Moreover, today much of the revenues collected by payroll taxes go to finance non-social security programs. As a result, the federal tax burden on ordinary Americans rose in the 1980s, even as the deficit grew and income gains slowed.

Coping with the Economic Squeeze

For most American families, the first lines of economic defense to these development have been to spend less and borrow more. Most young families now forgo owning their own homes; older families who already are homeowners scrimp in other areas. In addition, nearly all families borrow more, especially with credit cards. While real median family income was stagnating from 1973 to 1988, the median family's inflation-adjusted consumer debt (including auto loans) rose by 17 percent, reaching more than $7,850 in 1988. This growing private debt burden, moreover, has left smaller savings for the great expenses of family life, educating children and retirement.

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[3] To some degree, technology and competition have softened the blow of slow income growth for working families. For example, the inexpensive availability of consumer electronics such as the VCR and personal computers and of new forms of entertainment such as cable television has improved some secondary aspects of the quality of American family life. Similarly, discount retailing and the declining cost of air travel has brought some upper-middle-class goods and services within reach of families with moderate incomes.

These tactics are often not enough, and many Americans have reorganized their family lives in order to protect their lifestyles in the face of the long-run downward pressure on wages. First, more mothers work, and more work longer hours -- and most profoundly so among families with very young children. Among all American women with children under age five, the share with paying jobs climbed from 29 percent in 1970 to 51 percent in 1988. Among all mothers, the share in the work force grew from 47 percent in 1975 to 67 percent in 1988, and the proportion of them working full-time rose from less than 58 percent to more than 63 percent.

Further, many Americans adopted an even more radical and personal strategy: They have postponed having their children until their finances are more secure, with the result that the typical family is smaller than it used to be. To be sure, the birth rate began to drop before income gains began to slow seriously, falling from 23.7 per 1,000 in 1960 to 18.4 per 1,000 in 1970. But the birth rate continued to drop as growth stumbled. By 1975 the rate had fallen to 14.6 per 1,000, and from that time to the present it did not exceed 15.8 per 1,000 -- until turning up in the last year. And while every mother's and couple's thinking about the timing and number of children is complicated and personal, it is fair to assume that shrinking economic prospects play a role in many people's decisions to have smaller families than did their parents.

These various coping strategies are not the end of the story, because they have their own economic consequences -- some of them just now becoming apparent. Flagging new housing demand among strapped younger families, for example, may be a factor in the country's spreading real estate depression. Also, people's high personal debt makes them feel more vulnerable, and actually be more vulnerable, to bad economic news; when the bad news comes they cut back their spending fast, a response which has accelerated the current business downturn. And the inclination of baby-boomers to reproduce themselves at a slower rate than their parents did is the basic factor in the long-run financing problems of the social security system -- and the reason for the seven increases in payroll tax rates in the 1980s.

Each of these strategies, moreover, has a natural limit, which many families face already. Once a family reaches its credit limit, it can borrow no more; and once both parents are on the job, no one else is left to send to work. And after parents stop having children at one or two, they cannot reduce any further the number of people they have to support.

As this occurs, two alternatives remain. As a society we can figure out ways of increasing the productivity and incomes of working parents; in effect, building a progressive family policy. Or, we can await another round of more radical coping techniques, with perhaps portentous consequences for the children.

An Agenda for Pro-Family Tax Reform

An effective family policy in the 1990s has to move beyond the traditional goal of guaranteeing that poor children are well-sheltered, well-fed and healthy. The scope of family policy must now expand to working families as well as poor ones.

Of all aspects of family policy, finding appropriate ways of reducing the tax burden on families is the most simple and straightforward. Today, the United States stands alone among the world's 18 advanced democracies in not providing any form of family allowance or government subsidy per child. Alone, we seem unwilling to actively support the social value of nurturance. The first principle of a new, pro-family tax policy should be that the government does not tax away income needed to support children, and this principle can be realized by increasing the current $2,100 federal-income-tax exemption for children to reflect the actual costs of raising a child today, or some $5,500-to-$7,000 a year, per child.

Applied across-the-board, this reform would cost the Treasury more than $40 billion in revenues; but for less than $10 billion, a beginning can be made by initially expanding the exemption for young children and by phasing out the larger benefit at higher incomes. For less than $10 billion, we could establish a $4,000 exemption for children under age six, phased down to the current levels by age 10; or a $6,000 exemption for children under age four; or a $6,000 exemption for children under age five phased down to the current level by age 8 and by total income of $60,000.

A pro-family tax policy should also recognize the profound problems and injustices visited on working-poor families, who would gain no support from an expanded children's exemption because they already owe no income taxes. For them, the Earned Income Tax Credit wage supplement should be expanded and revised to ensure that anyone who works full-time, year round, would earn enough to support a family above the poverty line.

In addition, single parents should be granted the income-tax-filing status of married couples, instead of their current classification as "heads of households," which carries a tax rate lower than that for singles but higher than that for married couples. The tax liability of single parents should reflect the burdens they share with other families, not the personal fact that they are without spouses.

Even in an initially-attenuated form, these three, basic pro-family tax reforms will be expensive; too expensive to be either tax-financed without raising the burden on strapped working families, or deficit-financed without raising interest rates. The course that avoids both pitfalls is simple to see and to say, but difficult to implement: We can pay for a progressive, pro-family tax reform by reducing other federal spending in a progressive way.

Tens of billions of dollars in current resources could be released for these purposes by government more productive. Under normal conditions, 3 percent is a benchmark for healthy productivity gains in the business world; a typical firm in Japan exceeds these gains routinely. Congress can mandate that every federal office, agency and department meet the same standard by cutting total spending on government personnel and administration by 3 percent, and in no way affect the support on which both poor and moderate-income Americans depend. Such cuts are an established technique in business for motivating each unit to put together its own strategy for raising productivity and getting more for less -- and no more than what Governors from Virginia to California are doing this year to solve their own state budget shortfalls.

This approach to producing a leaner bureaucracy could save $6 to $7 billion in the first year from the $190 to $220 billion currently spent running and operating the federal bureaucracy; and by the end of the second round of cuts, the government's costs to operate would be pared by $15 billion. And these estimates do not include any productivity reforms in the uniformed military, where substantial savings may also be found after we conclude the Persian Gulf operation. But the savings from more efficient civilian operations alone could cover the basic planks of a progressive, pro-family tax policy.

The economic squeeze on families could be eased further by reforming social security taxes, the fastest-growing part of the tax burden for all families but the very affluent. Once again, the rising tax burden on average Americans was driven in the 1980s by seven increases in the payroll tax rate; all told, the 1980s saw an individual's maximum social security payment grow by more than 65 percent, after inflation. Yet well-to-do families, whose pre-tax incomes grew five times as fast in the 1980s as an average working person's, escaped most of the impact of these rate increases, because so much of their income is exempt from payroll taxes -- everything over $53,400, and all their capital income.

The question before Congress should not be whether payroll taxes should be reformed, but how. Senator Moynihan's proposal to adopt a pay-as-we-go system should be considered seriously, with debate focusing on the consequences of effectively eliminating the Trust Fund and on how the attendant impact on the budget deficit could best be offset.

Last year, the Progressive Policy Institute developed an alternative way of reducing the payroll tax burden on average people without touching the Social Security Trust Fund or expanding the budget deficit: Raise the same revenues for the Trust Fund by applying a lower tax rate to a larger tax base, as the 1986 tax reforms did for the income tax. And the fair and efficient way of doing this is to remove the "cap" that today exempts from social security tax all wage income over $53,400 and use the additional revenues to cut the tax rate. This progressive reform would bring tax relief to 95 percent of all workers and finance it with a dose of tax equity in which highly-paid people, like everyone else, would pay social security tax on all of their wages. The final result: a half-percentage point cut in the payroll tax rate, enough to increase an average-income family's take-home pay by $260.

The currennt Administration and its predecessor have had more than decade to help ease the economic stress on the nation's families; now it is time for Congress to step forward. The long-term economic interests of all American families demand greater investments, both in national resources and ingenuity, in education, job training, research and development, and our infrastructure. But I submit that right away, poor, moderate and middle-class Americans families alike also need tax reform. I urge you to provide the leadership they need.

* * *

Chairwoman **Schroeder**. Thank you. We really appreciate your testimony. It was right on point.

Next the panel welcomes Gary Bauer, who is the president of the Family Research Council. We will put your statement in the record and the floor is yours, Mr. Bauer.

STATEMENT OF GARY L. BAUER, PRESIDENT, FAMILY RESEARCH COUNCIL, WASHINGTON, DC

Mr. **Bauer**. Thank you, Madam Chairwoman. I would like, if I could, to just make a couple of general observations and, as you have indicated, have my statement submitted.

Madam Chairwoman, I have been in Washington now for about 20 years, and during the time we have both been in Washington, I have had a hard time recalling an issue where you and I agreed. As I realized that both of us agree on this issue, I assumed there were only two explanations: one, that one of us had miscalculated, or that, second, this idea really has a lot of power to it and a lot of common sense to it.

I think you have concluded, as I have, that, in fact, it is a very powerful idea that has the potential to unite Republicans and Democrats, liberals and conservatives, and feminists and traditionalists. So I'm looking forward to working with you on it and trying to pass it in the months ahead.

I think in a hearing like this there is a tendency to get tied up with figures and numbers, because those are very important, but I also think everybody in the room knows that we're really talking about real live American families. I assume that everybody on the committee has had a chance, as I have, to travel around the country and actually talk to mothers and fathers that are wrestling with the challenge of finding the money to pay education expenses, housing expenses, health care and so forth.

I thought it was interesting that Celinda Lake said in her opening testimony that Americans fear that by the year 2000 the middle class may, in fact, disappear. I'm not surprised that many Americans think that, given the economic strains that they're under.

I think the fact that so many parents and so many households have been driven into the work force—not necessarily because they want to be but because they can't pay their bills without two incomes—you can see what some of the economic trends are and what the major argument is for passing this exemption.

The third point I wanted to make is that, for those who are not familiar with the Family Research Council, we are a grassroots organization and we deal with a lot of issues. I want to assure the members of the committee today that we're going to be making a major effort with our members to convince your colleagues to sign on to this idea. We've got about 100,000 people around the country who are public policy "junkies", and they're going to be hearing from us about the personal exemption and why they ought to be supporting Congressman Wolf and you, Madam Chairwoman, to support the idea and get it through the Congress.

The final point I would like to make is that in my statement we talk about a lot of other quirks in the tax code that we don't particularly like. Some of those quirks are biased towards poor children, and others are biased toward rich children. But I think in all cases, middle class children have really been hurt by the tax code.

We think an increase in the personal exemption is a good step forward, but we also want to announce today that the Family Research Council, along with the Heritage Foundation, will be coming up with an overall reform idea to look at down the road after this increase in the exemption has been passed. Our overall reform would establish an overall child credit for families that would be linked to the payroll tax, as again Celinda Lake indicated many Americans would be interested in doing. So we are looking forward to working with you on this idea and then, down the road, doing a more comprehensive reform of the tax code to help American families.

Thank you very much.

[Prepared statement of Gary L. Bauer follows:]

PREPARED STATEMENT OF GARY L. BAUER, PRESIDENT, FAMILY RESEARCH COUNCIL, WASHINGTON, DC

MADAME CHAIRWOMAN, I want to take this opportunity to congratulate you for holding this hearing on the tax treatment of families with children, and to thank you for allowing me to be appear before your committee today. I believe the 102nd Congress has an historic opportunity to remedy a host of tax problems affecting families with children, and I am pleased to see you and the distinguished ranking member, MR. WOLF, stepping forward to provide leadership in the House on this extremely important issue.

MADAME CHAIRWOMAN, the federal tax code is riddled with all sorts of anti-family biases, inequities, and quirks. Some favor rich kids. Others favor poor kids. Almost all disadvantage middle-income children, especially those with parents who strike a good balance between meeting work and family responsibilities.

As a consequence, it is possible for some couples earning $100,000 to receive $8 in child-based tax savings for every $1 claimed by some median-income families (see note at end for explanation of computation). Likewise, it is possible for some low-income mothers with out-of-wedlock children to receive $5 in tax-related cash transfers for every $1 claimed by some median-income married couples with children. (And this does not even take into consideration food stamps, AFDC, nutrition benefits, day care assistance, Pell grants, and other government services for the poor.)

Despite all of the talk these days about tax "fairness," official Washington has given little attention to five serious inequities in the tax treatment of families: (1) the bias against children; (2) the bias against middle-income families; (3) the bias against childrearing; (4) the bias against low-income, two-parent families; and (5) the bias against simplicity. Each of these problems bears closer examination.

The Bias Against Children

MADAME CHAIRWOMAN, as you have so eloquently pointed out, taxpayers in America today can receive a bigger tax break for breeding racehorses than raising children.

Indeed, from an historical perspective, the tax code today views children more as a consumption item (like, say, a speedboat, a Persian rug, or a case of Chardonnay) than a socially beneficial private investment (like, say, an Individual Retirement Account or the United Negro College Fund).

For example, federal income and payroll (combined employer-employee) taxes in 1948 claimed just two percent of the annual income of a median-income family of four. Today, federal income and payroll taxes claim 24 percent of the annual income of a median-income family. In addition, state and local taxes, on average, siphon another eight cents from every family dollar.

Moreover, the income tax burden on a median income family of four has risen 150 percent since the mid-Fifties, while remaining fairly constant for childless couples and single taxpayers.

The erosion in the value of the tax exemption for dependents is the primary reason for this dramatic increase. The dependent exemption is the tax code's chief mechanism for adjusting tax liability to account for differences in family size. It is the tax code's way of acknowledging that raising children is both socially desirable and expensive.

If the exemption shielded from taxation the same proportion of annual income in 1991 as it did in 1948, a median-income family today would be able to exempt approximately $8,000 per dependent child. Instead, it can shield only $2,150.

While the growing tax bias against children can be seen in the failure of the dependent tax exemption to keep pace with wage and price inflation, the payroll tax treatment of families with children offers yet another illustration of this bias. As you know, the payroll or FICA tax is used to finance the Social Security trust fund. Although all employees are taxed at the same rate, all taxpayers do not make an equal contribution to the Social Security system. The reason is quite simple. Social Security's survival depends on contributions of two kinds: (1) money to support today's retirees; and (2) children (future workers) to support tomorrow's retirees. Thus, individuals without children make a single contribution to the Social Security system while families with children make a double contribution.

Nevertheless, no adjustment is made in the payroll tax to recognize the double contribution of parents. As a result, some analysts like Allan Carlson of the Rockford Institute have pointed out that the Social Security system provides an incentive for young adults to eschew childrearing and "live it up" today on the money that might otherwise go to support children, knowing that upon retirement, they will be able to live off of Social Security and other old-age benefits financed by other people's children.

The existing payroll tax bias against families with children should give pause to those attracted to proposals to reduce the FICA rate. Because such proposals do not differentiate between taxpayers with children and those without, they offer a childless couple earning $100,000 a year three times the tax savings available to a median-income family of four.

Moreover, any tax package featuring as its centerpiece an across-the-board payroll tax rate cut represents a repeat of the tax cutting priorities found in the last two major tax reduction bills -- the 1981 Reagan tax cuts and the 1986 tax reform act. While each of these bills modestly improved the tax treatment of families with children (the dependent exemption was indexed for inflation in 1981 and virtually doubled in 1986), both had as their central feature a reduction in marginal tax rates. Given this fact, and the magnitude of the bias against children, it is difficult to justify yet another tax bill which places a greater priority on reducing tax rates than on increasing pro-child tax benefits.

The Bias Against Middle-Income Children

MADAME CHAIRWOMAN, since families with different incomes are taxed at different rates under a progessive income tax system, the actual value of a $2,150 exemption varies by tax bracket. Thus, a $2,150 exemption generates $667 in actual tax savings to upper-income families in the 31 percent tax bracket, $602 in tax savings to upper-middle-income families in the 28 percent tax bracket, and $323 to middle- and lower-income families in the 15 percent tax bracket.

The fact that a tax exemption produces uneven tax savings depending on one's tax bracket would not be a terribly serious problem if, as in 1913 when the income tax was created, exemptions were high enough to free all but the wealthiest Americans from income tax liability entirely. Nor would it be a terribly serious problem if, as in 1948, high tax exemptions and low payroll rates left the average family with a modest overall tax burden.

The disparate impact of tax exemptions is now a serious problem because high taxes on parents -- due to the erosion of the dependent exemption, the dramatic increase in the payroll tax, and the growth in state and local taxes -- seriously undermine family autonomy, leaving many families vulnerable to becoming dependent on government programs (welfare, day care, etc.) that supplant family functions and discourage economic self-sufficiency.

To offset the disparity in tax benefits, Congress has, in recent years, provided tax benefits to low-income families with children through the Earned Income Tax Credit. These benefits, which in 1991 offer families as much as $1,600 for the first child, are limited to families with incomes below $22,000. Thus, a child born to a middle-income family has a significantly lower "tax value" than one born to richer or poorer parents.

The Bias Against Childrearing

MADAME CHAIRWOMAN, crazy as it may seem, the tax code penalizes parents for spending time with their children by narrowly linking certain tax benefits to day care expenses. In fact, the Dependent Care Tax Credit (DCTC) and employer-provided Dependent

Care Assistance Plans (DCAPs) are constructed in such a way that the more time a child spends in day care (and, therefore, the higher the family's day care expenses), the greater the tax benefits.

Although growing economic and cultural pressures make it difficult for some parents to spend as much time with children as they would like, tying tax benefits to day care expenses makes matters worse. It penalizes parental efforts to maximize the amount of care they provide their children. This "parenting penalty" is especially egregious in view of the fact that families earning $100,000 a year can claim tax benefits worth up to $1,925 for day care expenses, while families earning $30,000 a year that care for their own children receive no comparable benefit. Zero.

Nevertheless, tying tax benefits to day care expenses is often justified as a means of recognizing that day care users have less "ability to pay" taxes since part of their income is absorbed by day care expenses.

This argument appears reasonable until one considers that it could be used to justify a tax break for just about any expense. A taxpayer who eats at restaurants or calls out to Domino's could argue that he has less "ability to pay" taxes than a family that prepares its own meals. Moreover, a taxpayer who pays someone to cut his grass could argue that he has less "ability to pay" than a family that mows its own lawn.

Indeed, *in extremis*, this reasoning could be used to justify tax breaks for people who hire housekeepers, butlers, gardeners, interior designers, and chauffers -- since there are some people who perform these services for themselves.

Day care tax credit proponents are quick to point out, however, that day care costs are unlike other expenses, that day care is a business-related expense that workers with children incur to produce income. According to this reasoning, tax breaks for day care are justified in the same way that tax breaks for other business-related expenses are justified.

Whatever merit this argument might have is undermined by the fact that the Dependent Care Tax Credit permits taxpayers to write off between 20 and 30 percent of their day care expenses even though many recipients are in the 15 percent tax bracket. In other words, the DCTC is clearly designed to be a tax subsidy program rather than a business expense reimbursement plan.

Moreover, unlike other tax-deductible business expenses, existing day care tax credits can be claimed by any taxpayer, regardless of whether or not they own a business. Thus, day care tax breaks bear little resemblance to other tax-deductible business expenses. If all business-related expenses worked like day care, all wage earners would be entitled to generous tax write-offs for commuting expenses, lunch expenses, and business attire expenses. No such tax breaks currently exist, and the only apparent justification for creating such credits would be if some larger social goal were attained by favoring say, expensive commutes over walking to work.

Likewise, linking tax benefits to day care expenses would be legitimate only if paid day care were indisputably better for young children than unpaid care by family members. But the current debate among child development experts is not over whether non-familial group day care has an overall positive effect on child development; it is instead over whether, or to what extent, day care has an overall negative effect on children's physical health, social development, and psychological well-being.

Accordingly, tax benefits which favor day care over parental care should be replaced by benefits available to all families with young children. This would make it more affordable for families to devote greater portions of their time to the important task of raising children and would recognize that there is great social benefit to private investments of parental time with children.

The Bias Against Low-Income, Two-Parent Families

Under current law, the wage supplement offered to low-income families with children through the Earned Income Tax Credit does not distinguish between married-couple and single-parent households. Consequently, a two-parent, one-child family with no tax liability receives no greater benefit than a one-parent, one-child family.

This policy fails to acknowledge the importance of promoting two-parent families. It fails to acknowledge the fact that marriage is the number one escape route from poverty and welfare dependency.

In addition, this policy fails to recognize that you get more of what you subsidize and less of what you tax. No doubt part of the reason for the increase in single-parent families in poverty in recent years is because current government policies facilitate divorce and out-of-wedlock childbearing. Likewise, the growing vulnerability of many intact, middle-income families with children is no doubt related, at least in part, to the growing tax burden faced by such families.

There is merit to offering wage supplements to low-income families with children. But these wage supplements should recognize that marriage fosters self-sufficiency and that children fare best when they have the opportunity to grow up in a two-parent home.

The Bias Against Simplicity

Not only has the value of pro-child tax benefits eroded in recent years, but the increasing complexity of the tax code deters some families from claiming all of the tax benefits to which they are entitled. This is particularly true for low-income families, who are often unaware of pro-child benefits like the Earned Income Tax Credit.

Moreover, several recent proposed increases in the dependent exemption have called for limiting increases in the exemption to taxpayers in certain income ranges. While such income limitations are usually motivated by legitimate equity concerns, restricting exemption increases on the basis of income opens up a Pandora's Box that further threatens the exemption's elegant simplicity and near-universal reach.

In addition, income limitations -- like the 1990 budget agreement's phase-out of the exemption for taxpayers with annual incomes above $150,000 -- pose a serious horizontal equity problem since a family of four at any given income level has higher basic living expenses (and, therefore, less ability to pay taxes) than a bachelor with an identical income.

Five Principles to Guide Pro-Child Tax Relief

MADAME CHAIRWOMAN, just as there are five major anti-family inequities in the current tax code, there are five major principles that should guide pro-child tax relief efforts.

1. Recognize the unique social value of children, by restoring to their 1948 value tax benefits keyed to the presence and number of children.

2. Recognize the worth and dignity of every child by providing per child tax benefits of equal value to all families which would be applied against federal income and payroll taxes.

3. Recognize the importance of parental time with children by replacing tax benefits narrowly linked to day care expenses with universal tax benefits available to all families with young children.

4. Recognize the superiority of two-parent families by structuring low-income family wage supplements to discourage divorce and illegitimacy.

5. Recognize the virtues of tax clarity and simplicity by distinguishing between tax benefits and wage-based cash transfers and by seeking to make pro-child tax mechanisms more "user friendly."

Incremental Steps or Major Overhaul?

MADAME CHAIRWOMAN, in addressing the five major anti-family biases in the tax code, Congress could expand the dependent exemption (to address the bias against children), move the EITC's Supplemental Young Child Tax Credit up the age and income scales (to address the biases against middle-income families, childrearing, and simplicity), and create a spousal EITC benefit (to address the bias against low-income, two-parent families).

As I indicated earlier, CONGRESSMAN FRANK WOLF, and his Senate colleague, DAN COATS, deserve congratulations for spearheading efforts to push for this kind of pro-child tax relief legislation in the 102nd Congress. Clearly, the WOLF-COATS bill to raise the dependent exemption is the most important piece of pro-family legislation introduced in this Congress, and passage of such pro-child tax relief should be a top priority for the leadership of both parties in the House. Indeed, your co-sponsorship of this extremely important legislation, MADAME CHAIRWOMAN, demonstrates that pro-child tax relief can and should unite Democrats and Republicans, liberals and conservatives, feminists and traditionalists.

While there is tremendous merit to addressing existing tax inequities in an incremental fashion, there is also merit to exploring a complete overhaul of the income tax treatment of families with children that would consolidate all existing tax relief mechanisms directed to families with children (the dependent exemption, the Dependent Care Tax Credit, Dependent Care Assistance Plans, and the Earned Income Tax Credit) into a single tax credit.

MADAME CHAIRWOMAN, I am pleased to announce today that the Family Research Council, in conjunction with the staff of the Heritage Foundation, has developed such a plan. Our proposal, the Tax Freedom for Families Plan, would offer a per-child tax credit worth $1800 for preschool children and $1200 for children ages 6 and up. This credit, which would be refundable up to the combined employer-employee level of the payroll tax, is superior to an across-the-board cut in the payroll tax because it targets assistance to the taxpayers that need help most -- families with children. In fact, the Tax Freedom for Families Plan would increase pro-child tax benefits to a level roughly equivalent to that provided in 1948. Importantly, all taxpayers with children would receive these per-child benefits, regardless of income level or child care arrangement.

In addition to this tax credit, the Family Tax Freedom Plan includes a Family Wage Supplement that works much like the existing EITC in that it offers cash benefits to low-income wage earners with children who have little or no income and payroll tax liability. This wage supplement would add up to 10 cents to every dollar earned for taxpayers with one child, an additional 5 cents on the dollar for families with two or more children, and an additional 5 cents on the dollar for two-parent families.

Thus, the Family Wage Supplement, unlike some child allowance plans, links cash benefits to responsible behavior (marriage, employment), thereby eliminating the existing bias against low-income two-parent families. It avoids the negative unintended consequences of a guaranteed minimum income plan, and separates tax relief mechanisms from wage supplement mechanisms. This is a significant advantage over the existing EITC which blurs the critical distinction between taxpaying families receiving tax benefits and non-taxpaying income-earners receiving wage-based cash assistance. Certainly, both groups are deserving of assistance, but both should not be treated the same. For example, limitations on family size (both the EITC and the proposed Family Wage Supplement currently cut off benefits after two children) are justifiable for cash transfer recipients who are not yet self-sufficient, but are inappropriate for low-income taxpaying families.

MADAME CHAIRWOMAN, as you know, tax fairness for families is long overdue. Whether you pursue an incremental strategy or a complete pro-child tax overhaul, I hope that the 102nd Congress will adopt a significant increase in pro-child tax benefits. Rather than concocting new ways to raid the family pocketbook, it is time for Members of Congress to find ways to let parents keep more of the money they earn and to let them make their own decisions about how to best balance their work and childrearing responsibilities. Fairer tax laws -- and, more importantly, stronger families -- are apt to be the result.

Thank you again for allowing me appear before your committee today. I look forward to working with you and MR. WOLF in the days ahead.

NOTE ABOUT COMPUTATIONS ON PAGE 1

* The 8 to 1 computation compares a married couple with a combined income of $100,000 in which one parent claims a $5,000 DCAP (salary reduction plan to cover day care expenses) through his/her employment. Combined with the $2,150 dependent exemption, this means the couple is able to shield $7,150 from income taxation and $5,000 from payroll taxation for their one child. This yields over $2,500 in tax savings, roughly eight times the tax savings available through the dependent exemption to a median income family with one child ($323). The 5 to 1 computation compares a low-income single mother with one child who is eligible for more than $1,600 in tax benefits through the Earned Income Tax Credit -- roughly five times the amount available to the median-income family with one child.

Chairwoman **Schroeder**. Thank you very much. I'm glad we're all united fighting for this. As Congressman Wolf pointed out, there's a lot of "Gucci shoes" outside the Ways and Means Committee that we're going to have to fight off, but I think it's very important that we do it.

The next distinguished panel member we have this morning is Dr. Timothy Smeeding, who is the project director for the Luxembourg Income Project. We are very anxious to hear what you have to say because I think you put it into a more global perspective. So we welcome you. We will put your statement in the record and the floor is yours.

STATEMENT OF TIMOTHY M. SMEEDING, PH.D., PROFESSOR OF ECONOMICS AND PUBLIC ADMINISTRATION, METROPOLITAN STUDIES PROGRAM, THE MAXWELL SCHOOL, SYRACUSE UNIVERSITY, AND PROJECT DIRECTOR, LUXEMBOURG INCOME STUDY, SYRACUSE, NY

Dr. **Smeeding**. Thank you, Madam Chairwoman, and distinguished members of this select committee.

I want to talk today a little bit about how other countries handle personal tax provisions. This is not to say this is how the United States should do it, but compared to other countries we are a little bit out of line, as many of my colleagues have pointed out.

Let me begin by talking, for instance, about a particular aspect of our tax system, the deductibility of child care expenses. Of the 11 major OECD nations, which I talk about in this paper, there are only four that have such a provision—France, for children up to age 3, Germany and the Netherlands, only for single parents, and the United States.

Gee, how come it's that way? Well, it's simple. It's because each of these other countries has a refundable child allowance or child credit, a universal payment to all children. It's accomplished through a refundable credit, not through a personal or child care deduction. Only four of these countries have personal deductions for children, which rise in value with people's incomes. The rest of them all have a refundable child allowance, a floor. It's usually fairly small, but it's delivered directly to children. Mothers and fathers can use it to purchase child care if they want, or to stay home and take care of their own kids. It doesn't distort their choice at all.

Now, if we want to move towards that sort of a system in the United States, we can. It's not very hard to do. But the exemption is not going to get you there. The exemption, unless it's refundable, and no one has that sort of a system, isn't really going to help these low-income families who are struggling to pay their bills.

If you took the personal exemption and made it into roughly an $800 refundable credit, or a $600 refundable credit, and use the Social Security Administration to distribute it to families, you put a floor under everybody's income. Then you could integrate that, as Gene Steuerle mentioned, with the means tested system. All these other countries have means tested welfare systems, too—most of them do anyway. This would make quite a large impact.

Now, one thing this Luxembourg Income Study project does, which I direct, is it collects comparable data on the well-being of families with children and the elderly for various modern nations around the world. Then it rearranges the data so that it's comparable. So you don't have to say it's not on the same basis or you can't compare this to that. In fact, the whole purpose of this project is to compare one country's income structure to that of another.

After you take the tax system in concert with the transfer system—and you can't look at one and then the other because they're integrated in most other countries—and you look at something important to Americans, like child poverty, across these countries, you find that we have the highest percentage of poor children of any of the eight large nations which I show on the table in my testimony.

As you well know, we have about 19 to 20 percent of our children who are poor. The next nearest country is Britain with 12 percent. The Canadians only have 9 percent of their kids poor. Why? Because they have this refundable child allowance, this child grant, that is relatively modest, but it underlies the rest of the system.

Now, we improved refundable credits in this country last year with the Deficit Reduction Act of 1990. We expanded the earned income tax credit, we put another credit in the tax code so that people could buy health insurance, and we put a special credit in the code for infants. We don't need another special credit. We don't need an earned income tax credit that, if employers don't negatively withhold, comes to a working family that needs it in, let's say, April of this year, some time after they've figured out their taxes, when they needed the money last year. That's not what we need. That's not what a working poor family, that's being withheld, that's paying their payroll taxes today, needs. And if employers don't do this on an interyear basis, nothing happens until you get to the IRS next February or March. That's not what we need.

So I'm with Gene Steuerle, who is among the foremost tax experts in this country. You couldn't get anybody better to advise you, believe me. He wrote most of what is in the Tax Reform Act of '86 in the late 1970s. If we work towards a refundable tax credit that's worth an equal amount to all of our children and we provide tax relief to low-income working families, we help remove children from poverty and we do it on an equitable basis, across all children and across all mothers.

That's what I think is important, and I would be glad to talk to you about any specific details of such a proposal. I've tried to avoid those because my statement will be entered into the record.

Thank you.

[Prepared statement of Timothy Smeeding follows:]

Prepared Statement of Timothy M. Smeeding, Ph.D., Professor of Economics and Public Administration, Metropolitan Studies Program, The Maxwell School, Syracuse University, and Project Director, Luxembourg Income Study, Syracuse, NY

I. Introduction

Madam Chairwoman and distinguished members:

I am pleased to appear before the Select Committee to discuss the tax treatment of families with children in the U.S. as opposed to other nations. Work in this area by myself and others, notably Pechman and Englehardt (1989), Kamerman and Kahn (1991), and Blank and Hanratty (1991), has provided the basic outlines of how the U.S. system differs from other nations.

To begin, two points must be stressed:

(a) Cross national comparisons of the income tax treatment of families are frought with difficulties because of the different economic and social objectives which each country tries to achieve with these systems: provisions to establish equity, fertility, married women's labor supply and single parenthood are often intertwined to produce a package of subsidies and penalties, incentives and disincentives which are attuned to the nation's overall economic and social structures and family policy objectives.

(b) the income tax system cannot be interpreted in solation from the income transfer system, particularly where family and child allowances and tax credits are concerned.

II. Systems of Tax Relief and Universal Grants for Families with Dependent Children

Because of these two caveats, one must be careful in interpreting specific isolated differences in family income tax parameters: credits, deductions, exemptions, allowances and zero bracket amounts across countries. It is much more informative to treat the entire system of positive and negative taxation and other transfers to find real differences and net outcomes across nations. For instance, of the 11 major OECD nations examined in Table 1, only 4 provide special but limited tax allowances for child care expenses (France only for children under 3; Germany and Netherlands only for children of single parents; and the U.S. on a limited, sliding-scale, nonrefundable credit basis). But all of these countries, except for Japan and the U.S. provide other refundable and universal child benefits in lieu of child care allowances. Sweden also provides free chid care, France adds in "ecole maternale" for all 4 and 5 year olds. Moreover, each of these 11 nations except for the U.S. and Japan provide universal refundable child tax credits and/or cash grants. Japan provides only the traditional personal income tax exemption for children, while the U.S. also provides the Earned Income Tax Credit (EITC). In many countries, e.g. France and Germany, fertility considerations lead to larger per child credits or allowances for additional children beyond the first. The U.S. has just introduced a minor EITC differentiation of $137 per year for families with more than one child, and a special $357 supplemental credit for infants.

However two features of the U.S. income tax and cash grant provisions stand out in Table 1: (a) their relatively small value relative to the average wage, and (b) their being tied to wages by means of a graduated (positive and then negative) percentage formula. Most other countries provide flat amounts of credit that are either exempt from tax, or are "taxed back" as part of the income tax base. These universal grants are largely independent of additional means - tested or welfare benefits such as AFDC and Food Stamps. The U.S. package as shown in Table 1 produces benefits (deductions) that are only 8.8 percent of the average production worker's (APW) earnings of $22,700. Only Australia is lower. Moreover as we more from the APW level to lower income levels, cash grants and refundable tax credits provide a secure floor under family income in most nations. The U.S. personal income tax exemptions provide limited tax relief, but they are not refundable, while the EITC varies in relation to earnings, and reaches a maximum only from $7,140-$11,000 and phases out by $21,000. Hence the U.S. tax relief and

Table 1. Tax Reliefs and Universal Cash Grants for Dependent Children, 1989

Country	Exemptions	Credits	Cash Grants[a]	Percent of Average Production Worker's Earnings[b]	Equivalent in U.S. Dollars at the APW Level
Australia			A$274[c]	4.2	957
Canada		C$65[e]	C$1,326[d]	29.9	6,809
Denmark			DKr 5,400	13.2	2,991
France			FF 16,218[f,l]	47.3	3,945
Germany	DM 2,484		DM 600[g]	12.9	2,934
Italy		L 96,000[h]	L 1,680,000	71.9	16,337
Japan	¥ 350,000[i]			10.8	2,446
Netherlands	Dfl 797		Dfl 3,104	56.2	12,772
Sweden			SEK 5,820	92.2	20,956
United Kingdom			£ 393[j]	14.2	3,225
United States	$2,000	$910[k]		8.8	2,000

Source: Pechman and Englehardt (1989), corrected by the author. Official documents of each country. Figures for 1989 are projections from 1988 based on current law, including indexation where applicable.

a. Per child for the first two children; in the form of direct cash transfers. Income tested welfare benefits excluded.
b. Calculated on the basis of APW earnings in each country relative to APW earnings in the United States; credits and grants converted to exemption equivalents on the basis of the first non-zero bracket tax rate except for France (see l). The APW earnings level for the USA was $22,736 in 1989.
c. Amount for first child. Second child receives A$390. Does not include family supplement for low-income families of up to A$2,288.
d. A refundable credit of up to C$559 is allowed for children 18 or over, depending on the parents' income.
e. Subject to certain ceilings.
f. Average of allowance for two children. Includes a family supplement of FF 9,054 per child, which is phased down above certain income levels.
g. Amount is DM 1,200 for second child, DM 2,640 for third child, and DM 2,880 for fourth child and any children thereafter.
h. Amount for a married couple. Child exemption for a head of household with two children is £ 456,000. Each spouse is entitled to this exemption.
i. Exemption from the local tax is ¥ 280,000.
j. Family allowance for a head of household is £ 265.
k. This is a credit of 14 percent of earned income up to a maximum of $910 for families with children with a phaseout in the income range of $10,240-$19,340. No allowance is made for families of different size.
l. In Sweden, France the cash grants are taken as direct fractions of the APW. Following the procedures in note b produces a child subsidy of 347 percent of the APW, due to the strange nature of the French tax and family allowance system.

universal cash grant system is even less generous at lower income levels than show in Table 1.

Note also that for the three countries which provide them, the child tax credits are relatively small. The Canadian, Italian, and U.S. credits are, respectively, .2, .4, and 4.0 percent (maximum) of the average production worker's earnings (APW) in Table 1. In Canada and Italy, these are supplemented by much more substantial universal cash grants. Presumably these differences are caused by the difficulty of providing child allowances via the income tax system for low income families on an intra-year basis. The U.S. income tax withholding system has two features that make it difficult to deliver substantial amounts of child benefits to low income families on an intra-year basis: (a) the reluctance of employers to provide negative withholding, and (b) the fact that non-earners receive no benefits from such a system. Our current EITC is plagued by these two problems, particularly the former. In fact, a check for the maximum 1991 EITC of $1235 in March of 1992 is not what a low-wage working poor family with children which struggles through all of 1991 with no income or payroll tax relief needs. If earnings-related systems like the EITC are to be expanded or improved upon, negative withholding by employers is absolutely necessary. To move beyond the current earnings related system in the U.S. to a universal system which is not tied to earnings and which provides timely relief to all families with children a separate structure for delivering benefits - be it the IRS or the Social Security system - will be needed.

To the extent that we choose to broaden the U.S. income tax base to include all forms of cash income - social insurance and means tested benefits - and use the system of income tax credits, exemptions, and zero bracket amounts to ensure vertical equity, the IRS may be the preferred integrative and administrative structure for such an expanded system.

III. Outcome

In order to capture the net effect of these allowances on families and their economic situation, we must move beyond the income tax structure and APW calculations in Table 1 to include the effect of payroll taxes and means-tested benefits as well as child allowances and income tax provisions on family income and poverty. Economic security comes in different packages in different countries. Clearly most other nations are more generous than the U.S. in providing universal child allowances via combined child tax credits and family cash allowances. But do other systems of transfer -- unemployment insurance and welfare -- and other types of taxation -- notably payroll taxes -- compensate for these differences? A look at the Luxembourg Income Study (LIS) data for eight nations provides an answer to this question, and the answer is not a good one from the U.S. perspective. Not only do we do worse in the universal tax and transfer dimension shown in Table 1, but we also do worse in welfare and other transfer systems. The net effect is to leave U.S. children with the highest poverty rates among the eight nations studied in Table 2 in the mid 1980s. The U.S. child poverty ratio at 40 percent of the median exceeds the eight country average by more than 2.5 times. Even among the two parent families most comparable to those focused upon in Table 1, the U.S. rate of 11.5 percent is more than double the eight country average poverty rate. Comparing Tables 1 and 2, we find a rough correspondence between the generosity of universal benefits and the resultant child poverty rates. Those countries that are more generous: France, Sweden, Germany, Canada and the Netherlands tend to have the best outcomes, those who are a somewhat less generous, United Kingdom and Australia, have higher child poverty rates. The U.S. is nearly the least generous, and has the worst overall outcome in terms of child impoverishment.

IV. Policy Implications

In order to produce better outcomes for families with children the U.S. must have more generous universal tax and transfer policies for families with children. Greater economic security can be obtained in a non-stigmatizing way through the U.S. income tax and transfer system and

TABLE 2

RELATIVE POVERTY RATES,[a] AT 40 PERCENT ADJUSTED MEDIAN DISPOSABLE INCOME AMONG CHILDREN IN EIGHT WESTERN NATIONS DURING THE MID 1980's[b]

Country (Year)	All Units[c]	Two-Parent Families[d]
United States (1986)	20.4	11.5
Australia (1985-86)	9.0	6.9
Canada (1987)	9.3	7.0
West Germany (1984)	2.8	2.2
Sweden (1987)	.8	.9
United Kingdom (1986)	12.4	9.9
Netherlands (1983)	3.8	3.8
France (1984)	4.6	3.7
Eight Country Average[e]	7.9	5.7

[a] Poverty rates are the percent of children living in families with incomes below 40 percent of the adjusted median disposable income in each country.

[b] See Smeeding (1991) for additional details.

[c] All persons age 17 and under regardless of living arrangements.

[d] All persons age 17 and under living with two adults, a married couple or two persons living as married and no other adults.

[e] Average is the simple average of the eight countries.

outside the welfare system if we are willing to make the effort. Key decisions concerning the differential treatment of children of working vs non working mothers, and flat grant systems vs earnings related graduated systems (like the EITC) must be made. Greater differentiation for families with children by number of children (and perhaps also age) are also needed. The expanded EITC - special supplemental infant credit - health insurance credit package created by the Deficit Reduction Act of 1990 is a start in this direction, but only a start. If we are to move beyond this start, we need to combine this collage with the existing child care credit and other child care subsidies to form a comprehensive package of universal taxes and transfers which acts as a floor beneath the UI, AFDC and Food Stamps systems. Even with revenues obtained from combining the EITC, child care credit and other existing programs mentioned above, the net cost of an $800 per child refundable credit would be an additional $20-40 billion dollars. Full taxation of all transfer benefits under the income tax and a 1 percent or smaller increase in all income tax brackets would create more than enough revenue to provide these amounts. The creation of such a system is therefore not beyond our means, but is it beyond our collective will?

I would be happy to answer any questions that you might have.

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Chairwoman **Schroeder**. Thank you very much. Dr. Steuerle may come after you for exposing him for the '86 reform. [Laughter.]

We appreciate very much your adding some insight to this.

Our next witness this morning is Heidi Brennan, who is the Co-Executive Director for Mothers at Home. We welcome you, Heidi, and we will put your statement in the record. The floor is yours.

STATEMENT OF HEIDI BRENNAN, CO-EXECUTIVE DIRECTOR, MOTHERS AT HOME, VIENNA, VA

Ms. **Brennan**. Good morning, Chairwoman Schroeder, Congressman Wolf, and other members of the committee.

Before I begin my statement, I would like to say that I share your genuine enthusiasm for the potential for consensus amongst the people that are here, and share a thought with you that I think the American people would benefit from; that is, the opinions represented here really belong in a multidimensional model of public opinion, that it is beyond the traditional left-right dichotomy, and that if we begin to see it as a multidimensional model, we will be able to make much more progress in how we perceive Americans' needs and how we address them.

The second this is, by way of example, to show you a little bit about the origins of our organization. When the three founders were once asked by a television reporter whether or not they were feminists, they all looked at each other perplexed. They had never thought about it and had never discussed it, because what they were doing was beyond what their ideologies were.

They all answered the question. One said, "Of course, I'm a feminist." The second said, "Absolutely not." And the third one said, "It's irrelevant." I think what that points out is that their mission to support families transcended their ideology. I think that's also true of this panel here.

I would like to introduce you to my organization. I would describe our interest in tax policy as it affects families, and to tell you what we have learned about the needs and desires of American families through the voices of its mothers. Oftentimes those voices are not heard because they're busy talking to the children and others in their community.

Mothers at Home was founded in 1984 as a nonprofit education organization to support mothers who choose or would like to choose to be at home in order to nurture their families. Our goals have been to help mothers at home realize they've made a great choice, one made by many smart women today, to help mothers excel at a job for which no one feels fully prepared—I might add that fathers don't feel prepared, either—and to correct society's many misconceptions about mothering.

We accomplish these through publishing a monthly magazine called "Welcome Home", and by researching, writing and speaking on topics of interest to today's mothers. This work is accomplished by volunteers and paid staff who all have choices for flextime, job sharing, and home-based work. Our office offers a unique family-friendly environment, where mothers can readily meet the needs of their children and participate in organizational business. Our utilization of creative management methods and modern technology demonstrate that mothers can integrate their roles as parents and business participants.

After over seven years of receiving thousands of unsolicited letters and phone calls from mothers in every State in America, we learned some surprising things. We have learned that mothers cannot be categorized by their work/home choices. The mothers who have contacted us represent a diversity of political, religious, socio-economic, career and educational backgrounds. We have heard from single mothers who have managed to stay home; we've heard from high-income women who feel they must work; we've heard from political conservatives who have balanced career and family for years, and we've heard from feminists who quit their job as soon as their first child was born. We realized at that point that media portrayals of women was inaccurate and that, despite the variety of their experiences and outlooks, these mothers share a common goal. They are seeking and developing new, more fluid life patterns that incorporate both a substantial commitment of time to nurturing their children, and that maintain their opportunities for employment, community service, career development, and personal enterprise.

However, our society's ability to understand this fundamental change for women is handicapped by outmoded definitions of work life and career paths. For example, our definition for employment, taken from the Department of Labor, is "Employed persons are those who, during the survey week, (a) did any work at all as paid citizens, (b) worked in their own business or profession or on their own farms, or (c), worked 15 hours or more as an unpaid worker in a family-operated enterprise. Also included are those who were temporarily absent from their jobs for such reasons as illness, vacation, bad weather, or labor-management disputes."

Serious misunderstandings about the needs and desires of mothers have arisen when statistics compiled under this definition are utilized to assess the need for particular social or economic programs.

Today's mothers have had education and career opportunities unknown to their mothers' generation. However, they find that their choices are limited by the constraints of taxation on family income, constraints which have been increasing for the last 40 years and have been extremely well-documented and presented by others testifying today.

The personal exemption of our tax code was created as the simplest and fairest way to support family life in America. Its erosion has been a primary source of economic stress and loss of freedom to our families.

What do mothers want and need? They are seeking a renewed economic freedom, a freedom to meet their goals for time spent nurturing their children and for creating new life/career patterns that would include sequencing, job sharing, flextime, employment, telecommuting, home-based business, and last but not least, serious recognition of achievement for those who forego employment to make lifetime contributions as homemakers and volunteers. These are the goals we have heard about for the last seven years.

Unfortunately, as these mothers sought ways to commit time to their children, they were derided as nostalgic. As fathers attempted to expand their options in parenting, they, too, were stymied in their efforts by the increased demands to earn income to help their families survive. And in this all, the needs of children were most forgotten.

Our Nation had become enthralled with every social program conceived, except the one that has sustained us throughout history—the family. A fair and equitable tax system must support the family as the most important socioeconomic program to a healthy, democratic society.

To summarize, mothers are asking, on behalf of themselves and their families, for a renewed regard for the importance of the work of caring for children and for the opportunity to create new ways to participate in all of the business of our Nation, ways that respect their family commitments. They are asking their elected leaders to remove economic barriers to doing that work, and they are saying that those barriers can be most reduced by making the following changes to the tax code:

One, expand the personal exemption from its current $2,050 to somewhere around $7,000, and two, to transform the current dependent care tax credit into a universal young child credit that does not discriminate between the choices made by families to care for their children. This current credit does not recognize the realities of the new work life.

Certainly there has been inertia in our society and by Government to address these problems. It seems that we have lost a sense of responsibility to the average American family to return their income to them so that they may carry out their basic functions. We have been captivated with the idea that social service programs can duplicate, even improve upon families themselves, and that the only work that counts is that which is compensated and, therefore, taxed. Our fascination for the measurement of society's productivity using the criteria of labor statistics and paid work units completely ignores the "work" that families do for themselves and for their communities out of love, commitment, and freedom. Those adults, primarily mothers, who devote significant time to the care of children and community service are not considered a part of our national productivity.

It is time for our Nation's leaders to transcend the political debate of the last decade. Many education and public policy organizations are establishing a consensus about the needs of families for time together and for tax relief. Some of those organizations are present here today. Certainly this hearing marks a new precedent in our national discussion of family needs. The spirit of collaboration which marks this effort of this committee and its witnesses must be carried over into the larger political arena.

In conclusion, I want to say that I'm not here merely to remind you of the importance of tax reform, but to urge Congress to assist you in providing dramatic reform. As our national culture reawakens to the critical importance of nurturing provided by parents to their children, Americans will no longer accept anything less than comprehensive action by our Nation's legislators for the support of families.

Thank you.

[Prepared statement of Heidi Brennan follows:]

PREPARED STATEMENT OF HEIDI BRENNAN, CO-EXECUTIVE DIRECTOR, MOTHERS AT HOME, VIENNA, VA

Good morning Chairwoman Schroeder, Congressman Wolf, and members of the committee. Thank you for the opportunity to submit testimony to you today. I would like to introduce you to the organization which I represent; to describe our interest in tax policy as it affects families; and to tell you what we have learned about the needs and desires of American families through the voices of its mothers.

Mothers At Home was founded in 1984 as a non-profit education organization devoted to the support of mothers who choose, or would like to choose, to be at home inorder to nurture their families. Our goals have been:

1. to help mothers at home realize they have made a great choice -- one made by many smart women today;
2. to help mothers excel at a job for which no one feels fully prepared;
3. to correct society's many misconceptions about mothering today.

We sought to accomplish these through publishing our monthly magazine, WELCOME HOME, and by researching, writing, and speaking on topics of interest to today's mothers. This work is accomplished by volunteers and paid staff who all have choices for flex-time, job-sharing, and home-based work. Our office offers a unique family-friendly environment, where mothers can readily meet the needs of their children and participate in organizational business. Our utilization of creative management methods and modern technology demonstrate that mothers can integrate their roles as parent and business participant.

After over seven years of receiving thousands of unsolicited letters and phone calls from mothers in every state of America, we learned some surprising things about who are today's mothers, and what they want and need for themselves and their families.

WHO ARE TODAY'S MOTHERS?

We have learned that mothers cannot be categorized by their work/home choices. The mothers who have contacted us represent complete diversity in their political, religious, socio-economic and career backgrounds. We have heard from single mothers who have managed to stay home, high income women who feel they "must" work, political conservatives who have balanced career and family for years, and ardent feminists who quit work as soon as their first child was born. We realized that media portrayals of women did not accurately reflect their life choices or needs.

Despite the variety of their experiences and outlooks, these mothers share a common goal. They are seeking and developing new, more fluid life patterns that incorporate both a substantial commitment of time to nurturing their children; and that maintain their opportunities for employment, community service, career development, and personal enterprise.

However, our society's ability to understand this fundamental change for women is handicapped by outmoded definitions of work life and career paths. For example, the U.S. Department of Labor utilizes a standardized definition of employment which reads:

"Employed persons are those who, during the survey week: (a) did any work at all as paid citizens; (b) worked in their own business or profession or on their own farms; or (c) worked fifteen hours or more as an unpaid worker in a family-operated enterprise. Also included are those who were temporarily absent from their jobs for such reasons as illness, vacation, bad weather, or labor-management disputes."

Serious misunderstandings about the needs and desires of mothers have arisen when statistics compiled under this definition are utilized to assess the need for particular social or economic programs.

Today's mothers have had education and career opportunities unknown to their mothers' generation. However, they find that their choices are limited by the constraints of taxation on family income; constraints which have been increasing for the last forty years and have been well-documented and presented by others testifying here today.

The personal exemption of our tax code was created as the simplest and fairest way to support family life in America. Its erosion has been the primary source of economic stress and loss of freedom to our families.

WHAT DO MOTHERS WANT AND NEED?

Mothers are seeking a renewed economic freedom -- a freedom to meet their goals for time spent nurturing their children and and for creating new life/career patterns that would include sequencing, job-sharing, flex-time employment, telecommuting, home-based business, and serious recognition of achievement for those who forego employment to make lifetime contributions as homemakers and volunteers. These are the goals that we have been hearing about from mothers for the last seven years.

Unfortunately, as these mothers sought ways to commit time to their children, they were derided as nostalgic. As fathers attempted to expand their options in parenting, they too were stymied in their efforts by the increased demands to earn income to help their families survive. And in this all, the needs of children were most forgotten. Our nation had become enthralled with every social program conceived except the one that has sustained us throughout history -- the family. A fair and equitable tax system must support the family as the most important socio-economic program to a healthy, democratic society.

To summarize, mothers are asking, on behalf of themselves and their families, for a renewed regard for the importance of the work of caring for children and for the opportunity to create new ways to participate in all of the business of our nation -- ways that respect their family commitments. They are asking their elected leaders to remove economic barriers to doing that work. And they are saying that those barriers can be most reduced by making the following changes to the tax code:

1. Expand the personal exemption to return its value to what it was when it was at its highest as a percentage of family income (from current $2050 to approximately $7000).

2. Transform the current Dependent Care Tax Credit into a universal young child credit that does not discriminate between the choices made by families to care for their children and provide economic sustenance.

WHERE IS CONGRESS?

Why has there been so much inertia in our society and by government to address the obvious problems? It seems that we have lost a sense of responsibility to the average American family to return their income to them so that they may carry out their basic functions. We have been captivated with the idea that social service programs can duplicate, even improve upon families themselves; and that the only work that counts is that which is compensated, and therefore, taxed. Our fascination for the measurement of society's productivity using the criteria of labor statistics and paid work units completely ignores the "work" that families do for themselves and for their communities out of love, commitment, and freedom. Those adults, primarily mothers, who devote significant time to the care of children and community service are not considered a part of our national productivity.

The first priority of a family is to care for itself. By penalizing its efforts through excessive taxation, we not only ignore the value and necessity of that work, but we suggest that the unpaid labor of nurturing is beneath our national dignity. We suggest that only_income, which can be taxed, is a pursuit worthy of political and social recognition.

We must accept that it is when families are free to act in their own self-interest that they build community life which both sustains healthy families and reaches out to the less fortunate members of society, helping them to make the human connections necessary for survival and growth.

It is time for our nation's leaoers to transcend the political debate of the last decade. Many education and public policy organizations are establishing a consensus about the needs of families for time together and for tax relief. Some of those organizations are present here today. This hearing marks a new precedent in our national discussion of family needs. The spirit of collaboration which marks the effort of this committee and its witnesses must be carried over into the larger political arena.

In conclusion, I want to say that I am not here to merely confirm for you the importance of tax reform to family life. I am here to assist you in conveying to the rest of Congress that it is ethically obliged to begin immediate and dramatic reform of our present tax code, providing fair and extensive tax relief to all families. As our national culture reawakens to the critical importance of nurturing provided by parents to their children, Americans will no longer accept anything less than comprehensive action for its support by our nation's legislators.

APPENDIX

The many thousands of letters from Mothers At Home has received have helped us to understand the needs of America's mothers and their families today. The following examples of comments we have received are part of a consistent pattern of concerns.

A mother from Rexburg, Idaho: "By increasing the dependent exemption we can give every family a financial boost. Then a mother can afford to choose to stay home to raise her own children or a family can afford to pay for day care of their choice. No center or type of care should receive government money. Families should receive the tax break."

A mother of three from Butler, Pa. writes: "Parents should not be taxed to a degree that they cannot provide for children. The government should stop spending and lower taxes."

From a mother of three in Chatham, New York. " Instead of funneling tax dollars to day-care centers, provide tax benefits (like better deductions) to families. As a counselor, I work with too many women who return to work but don't want to."

A new mother from Wisconsin writes, "If they allow a tax credit for child care outside of the home, I think it is only fair for mothers in the home to receive the same."

From a mother in Veradale, Washington: "The current incentive (Dependent Care Tax Credit) encourages people to send their children to day care. A better goal would be to encourage people to care for their own children as much as possible." Society has given no monetary value for people to care for their own children."

A mother from Virginia writes: "I worry that I will be forced to work because government is more interested in my money than what is best for my family."

We have also heard from employed mothers desperately searching for ways to afford to quit their jobs so that they could care for their families.

From a mother in Pennsylvania: "I got a surge of hope and energy after reading about your group. I'm a working mother, albeit a very, very reluctant one. My daughter will be six months old tomorrow and not a day goes by without me grieving over losing precious days with her. I have to work, but my husband and I are doing everything possible to get ourselves on our feet financially so I can work part-time by autumn."

From a mother in Haymarket, Virginia: "I am, unfortunately, a working mother who commutes 50 miles each way. It's hard to have a young child and leave for work at 5:45 am. I do feel very frustrated concerning my need to work. I would like to be home full-time, until school age, anyway."

From Grand Rapids, Michigan: "I am writing in response to a recent show I saw on mothers who stay at home. The comment was made about-hoping to provide an economical way for mothers who are forced to work to be able to stay home more with their children. I was very interested in this because I am in that situation."

The evidence we have collected over seven years has been consistently confirmed by numerous opinion polls.

* A USA TODAY survey found that seventy-three percent of all two-parent families would have one parent stay home with children if "money were not an issue".

* A Mark Clements Research survey found that 88 percent of mothers who were working eiher full- or part-time agreed with the statement, "If I could afford it, I would rather be home with my children."

* A Cornell University study found that two-thirds of all mothers employed full-time would like to work fewer hours so that they can devote more time to their families.

* A Lou Harris poll found that eighty-two percent of the American public believe it is best for young children to be cared for by one or more parents or by extended family members.

ADDENDUM TO MOTHERS AT HOME TESTIMONY BY HEIDI L. BRENNAN
before the
SELECT COMMITTEE ON CHILDREN, YOUTH, AND FAMILIES
U.S. HOUSE OF REPRESENTATIVES
APRIL 15, 1991

APPENDIX II - THE DEPENDENT CARE TAX CREDIT

BACKGROUND

The Dependent Care Tax Credit (DCTC) was introduced in the early 1970's as a strategy for helping families cope with the increasing cost burden of caring for children when the parents' participation in the paid labor force resulted in out of pockect expenses for child care. It was also justified as a means to maximize women's choices for labor force participation, by providing an incentive to earning income.

Care of children remains as a significant priority for our national political agenda. However, the means to address it must transcend the narrow ideological political discussion of our recent past. It also requires that we acknowledge accumulated information about what constitutes the best care for children and the desires of families to provide that care.

The DCTC has become seriously outmoded as a vehicle for helping families balance the costs of working and caring. It needs to undergo immediate change inorder to provide tax fairness for all families. A universal child tax credit, not linked to documented child care expenses, would be a more effective means to recognize both the cost and value of caring for children.

PRACTICAL CONSIDERATONS

The primary goal of the DCTC was to address the cost of child care associated with the laborforce participation of parents. As family income has declined, this credit became more important to many families inorder to help them meet basic expenses.

However, the goal of helping families pay for care was not being adequately met, because many families used child care arrangements which did not involve any compensation to the caretakers, who were primarily members of the extended family. Furthermore, increasing numbers of middle income families sought ways to enhance family income while maintaining a personal priority for parental care. Here are some examples of "working" families who do not benefit from the current DCTC:

1) "Tag-team" parents - According to the 1990 Census Bureau report ("Who's minding the Kids?"), this arrangement represents care for children in 8 percent of our nation's families with children under the age of 5. Mothers At Home has heard from parents who would like to be able to opt for this approach but are unable to do so due to economic burden and/or lack of flexible work opportunities.

2) Home-based employment of a parent - Many mothers are choosing or seeking paid work opportunities at home. They represent a new wave of entrepreneurs. Fathers too are interested in the potential for work-at-home options inorder to maximize family time. While some may view this as a choice more available to middle and upper-middle income families, it is important to recognize this as an opportunity desired by lower income families as well. (An interesting example for low-income women is the Women's Self-Employment Project in Chicago).

3) Flexible and part-time work arrangements - In poll after poll, working mothers state as their number one priority the desire to find employment that allows them to spend more time with children and other family members. For many mothers at home, these options provide a preferred career path for making a future transition from full-time care of young children to a different balance between laborforce activity and family care as their children enter school.

It is difficult to count how many people in this group currently don't benefit from the DCTC, because it combines those who: a) use relatives who do not receive compensation; b) exchange child care with other adults in an informal partnership arrangement; and c) work only during the hours children are at school.

Obviously, many families who should be eligible for the DCTC due to economic need, simply are not eligible for a credit determined exclusively by financial reimbursement for child care expenses.

THEORETICAL CONSIDERATIONS -

One of the arguments used to defend the DCTC is that it provides "horizontal income parity" (see testimony of the National Women"s Law Center). The concept of horizontal parity suggests that one goal of the DCTC is to give a boost to the two-earner family whose primary earner's income is below that of a single-earner family with the same gross income, which cares for its own children. "Horizontal parity" is simply a false notion. A look at some examples of dual parent households with two young children might make this clear.

Family # 1	Family #2
1 earner - 25,000	1st earner 25,000
parental care	2nd earner 10,000
no credit	purchased daycare,
	eligible for credit

Family #2 receives a tax incentive to raise their family income above Family #1 and to do so by transferring the daily care of their children to paid substitutes. What exactly is the parity in this situation" It simply offers tax benefits to the paid transfer of child care in the second family, penalizing the decision of the first family to forego income inorder to provide parental care.

Another significant issue is the lack of phase-out for the DCTC at higher incomes. The debate about the DCTC usually shifts at this point from defending the credit as a necessary income support to financially-stressed working families, to an esoteric argument that child care is a legitimate business expense.

This argument ignores obvious differences between business and personal expenses. Child care is a personal expense borne by an individual, just as transportation, clothing, and most other work-related expenses are personal, and not deductible. A close look at business expenses that may be deducted by an employee shows that they are tied directly to meeting specific performance standards or job-related activities. The fact that the tax code currently provides a credit for child care expenses does not justify it as a business expense.

Businesses face a different set of costs, a different set of risks and opportunities, and a different set of tax rates than do individuals. Businesses employ people, who must may taxes on personal income, as do the business owners themselves. Businesses have obligations to pay certain benefits, fees, licenses, insurances, etc.

Frequently, the tax credit for child care expenses is compared to some business tax write-offs, such as entertainment, as a means to justify its value. No one would argue that caring for children is less important than a business lunch. However, if the real problem is that families bear too much of the cost of government as compared to business, than the answer is not to expand or maintain child care credits as a business expense, but to change our priorities for taxation. Maintaining the DCTC essentially reduces the cost of labor for business by providing tax incentives only to those families who enter the paid laborforce.

Ultimately, a dependent care tax credit makes familial care of children an activity valued as subsidiary to monetary gain and the "production" of taxable income.

PHILOSOPHICAL CONSIDERATIONS

Those who forego or reduce hours of paid employment to voluntarily care for others, while supported financially by other family members to do so, sacrifice income potential and many other career/income benefits inorder to deliver important services to society. Whether they care for children, older adults, those who are ill or handicapped, or contribute thousands of hours in volunteer work within their communities, the value of these hours can never be adequately measured. And for that reason, they are not counted as part of our national productivity. The idea of the DCTC as a "business expense" is one which promotes a cash nexus as the primary relationship between family members, resulting in an excessively material view of family a view not supported by an overwhelming majority of American families.

Chairwoman **Schroeder**. Thank you very much. We really appreciate your being here.

Our final witness this morning, who has been terribly patient and we thank you, is Nancy Duff Campbell, who is the Managing Attorney of the National Women's Law Center. Nancy, we welcome you. We will put your statement in the record and the floor is yours.

STATEMENT OF NANCY DUFF CAMPBELL, MANAGING ATTORNEY, NATIONAL WOMEN'S LAW CENTER, WASHINGTON, DC

Ms. **Campbell**. Thank you very much, Congresswoman Schroeder. I am happy to be here today. I would like my statement to go in the record and I'm just going to summarize some of the points in it.

Let me begin by saying that my testimony is considerably more pedestrian than that of the other panelists. I have assumed for purposes of my presentation that the tax code is not going to change a lot, although many of the ideas that have been advanced here are ideas that we should be examining. Particularly some form of a child credit that is big enough and substantial enough to be comparable to some of the credits of our European partners, and that is integrated with our public assistance system, would be very beneficial. I have assumed that we are not going to move very quickly in these times to such global changes.

I have been asked to focus on the current dependent care tax credit, particularly to tell you a little bit about why I think that credit, at least in the current system, should be retained and should be improved, because changes in the Tax Reform Act of 1986 and in the Family Support Act of 1988 have eroded substantially the value of this credit, particularly to low- and moderate-income families.

As you know, the dependent care credit provides a tax credit—and I should say it is not a deduction but a credit and, therefore, more valuable for those at the lower end of the income scale—to families that have dependent care expenses, expenses for the care of children or for adult dependents.

It really serves two purposes, and these purposes are different from a children's allowance or the earned income credit or the personal exemption that we've been talking about so much today.

The first purpose is to provide some help to families who have dependent care expenses, because these expenses are so large in a working family's budget. After shelter, taxes and food, they are the largest expense that a working family has. So Congress recognized that when work expenses are that large, the tax code should recognize that and give some help to those families.

The second purpose that the credit serves is one of helping to provide horizontal equity in our tax code. By that I mean it says, if you take two families who have the same income and the same family size, the one that has dependent care expenses is less able to pay taxes than the one who does not. Therefore, that family should get some help with that very large expense to try to make their ability to pay taxes more like the other family. So you have to remember these purposes in evaluating the credit and in comparing it to proposals such as those to increase the personal exemption.

Now, what has been going on since 1986 and the Tax Reform Act is that, because the Tax Reform Act did not index the dependent care credit—but indexed virtually all of the other provisions that determine tax liability—more and more the people at the lowest end of the income scale are having no tax liability and, therefore, getting no benefit from the credit because it's not a refundable credit.

As time goes by—and from '86 to just '89, there's been a 71 percent decline in the number of families under $15,000 who are taking this credit, and a 73 percent decline in the amount they have received—as time goes, by that will continue, until finally the credit will really only be there for those at the upper end. So, that failure in the Tax Reform Act of '86 should be redressed. There is no reason why this credit, like all the other components of tax liability, should not be indexed for inflation and made refundable.

Secondly, changes in the Family Support Act of 1988, most notably the requirement that families provide the Social Security number of their provider, have resulted in another big reason for the decline in the number of families taking the credit.

Now, we have no quarrel with this requirement. We believe that families should provide the Social Security number of their providers and that all families in the United States should be reporting their income and paying tax on their income. In fact, we think that, over time, as families understand this requirement, and as providers understand that in most instances they will do better by reporting their income—because their salaries are so low that they could get tax benefits, including the dependent care credit and the earned income credit—that more families will report their income. So the effect of this change, which was a big blip really between '88 and '89, will begin to level out.

But the combination of these two changes at once is really making the credit much more compressed, so that in terms of its distributional effect, it is becoming much more a middle- and higher-income credit than it is a low- and moderate-income credit, as it was intended to be.

So what should be done to correct this? I should say I explain in more detail in my testimony the reasons for these changes and some of the data that show the widespread effect that they have had. First, the credit should be retained, as I said, unless we are really looking at more global, expansive changes that would try to assure that families do get help with their dependent care expenses in some other way, such as under some of the European models. The credit should be retained. It should be indexed for inflation so that it continues to be targeted to those at the bottom end of the income scale, and it should be made refundable for the same reason, particularly so that the lowest-income taxpayers can get some benefit from it.

Now, many have said that because of these distributional changes, as more and more people at the higher end become the primary beneficiaries of the credit, that the way to deal with that is to put a cap at the top and to not allow families with incomes above a certain level—usually about $70,000—to obtain any benefits from the credit at all.

We oppose this so long as other employment-related tax benefits do not have income caps. If you were to cap the credit and not deal with other employment-related benefits, you would have a situation where taxpayers at all income levels could deduct their oriental rugs for their offices, their boats that they take their clients out on, and many other employment-related expenses; yet taxpayers couldn't take a credit for their dependent care expenses which are so essential to enable them to work. So if you want to put a cap on employment-related expenses, do it, but do it across the board. Don't single out dependent care as the first such hit in any kind of reform.

I want to close by thanking Congresswoman Schroeder for inviting me and also for being a champion of the credit over so many years. Many of the changes that I have discussed have been a part of the Women's Economic Equity Act for several years, of which she has been one of the chief sponsors. I thank you for having me here today.

[Prepared statement of Nancy Duff Campbell follows:]

PREPARED STATEMENT OF NANCY DUFF CAMPBELL, MANAGING ATTORNEY, NATIONAL WOMEN'S LAW CENTER, WASHINGTON, DC

Madame Chairwoman, and members of the Committee, the National Women's Law Center is a national women's legal organization that has been working for nearly twenty years to protect and advance women's legal rights. We are pleased to have this opportunity to testify before the Committee today on tax issues affecting families.

The focus of my testimony will be the dependent care tax credit. This credit has provided significant federal assistance to millions of families with child and adult dependent care expenses since its enactment in 1976. In recent years, however, the value of the credit has begun to erode, particularly for low- and moderate-income families. The reasons for this erosion, and improvements that might be made in the credit to ameliorate its effects, will be addressed in my testimony.

The loss or reduction in value of tax support for dependent care expenses is significant for many families who are struggling to accommodate employment with care for their dependents. This tax support is particularly important to women, who most often bear the responsibility of arranging care for children and elderly and disabled dependents.

The increase in the labor force participation of women has brought a concomitant increase in the demand for child care. Census Bureau data reveal that more than 73 percent of mothers with children age 6-13 are in the labor force. Almost 61 percent of mothers with children age 3-5 work outside the home, as do 53 percent of mothers with children under age 3.

In addition, many employed women are responsible for the care of older and disabled relatives. A survey conducted by The Travelers Companies in 1985 found that about 20 percent of its home office employees age 30 and older were providing at least some care for an elderly parent, relative, or friend. A study by the National Center for Health Services

Research of the Department of Health and Human Services, based on a 1982 population sample, found that 1.2 million moderately- to severely-disabled persons age 65 and over were being cared for in their homes by family members and friends. In addition, data for 1983 reveal that 8.4 million severely-disabled adults between the ages of 18 and 64 live in families with at least one other adult.

Finally, care for both children and other dependents can be quite expensive. After food, housing and taxes, child care is a working family's largest expense. Costs for out-of-home care for children vary widely depending upon the type of care and age of child, with the average cost of full-time care, according to a 1989 study, approximating $3,500 per year, per child. Adult care is even more expensive. A 1986 study based on a sample of 549 day care centers by the National Institute on Adult Day Care of the National Council on the Aging found that the average per diem cost of care ranges from $27 to $31. It is not surprising that many families do not have the financial resources to pay for adequate care. This is particularly true for single heads of household, whose incomes are much lower and poverty rates much higher, on average, than those of other families.

The dependent care credit allows taxpayers who have employment-related expenses[1] for the care of a child under age 13, or for the care of a spouse or any other dependent who is physically or mentally incapable of self-care, to set off a percentage of those expenses against their federal income tax liability. The amount of credit that may be claimed is determined by the amount of the taxpayer's expenses and the taxpayer's adjusted gross income (AGI).

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[1] Only expenses paid to enable the taxpayer and, if married, both the taxpayer and the taxpayer's spouse, to be gainfully employed or to seek gainful employment are eligible for the credit. Special rules apply when the taxpayer or the taxpayer's spouse is a full-time student or incapable of self-care.

With respect to expenses, for all taxpayers eligible expenses may not exceed $2,400 for one dependent or $4,800 for two or more dependents. With respect to AGI, the credit is targeted to provide the greatest benefit to low-income taxpayers. Taxpayers with AGIs of $10,000 or less are eligible for a credit equal to 30 percent of their qualifying expenses, while taxpayers with AGIs over $28,000 are eligible for a credit equal to 20 percent of their qualifying expenses. Between $10,000 and $28,000 AGI, the applicable percentage declines by one percentage point for each $2,000 increase in AGI. Thus, the maximum dependent care credit for taxpayers with AGIs below $10,000 is $720, for one dependent, and $1,440, for two or more dependents, and for taxpayers with AGIs above $28,000, is $480, for one dependent, and $960 for two or more dependents. The credit is not refundable; that is, a taxpayer must have tax liability to offset before any benefit may be received from the credit.[2] The credit is also not indexed for inflation.

The dependent care credit serves several purposes. As a dependent care measure, it recognizes that child and adult dependent care is a significant employment-related expense for working families, and that government should provide some help to families in meeting that expense, especially lower-income families. As a tax measure, the credit promotes "horizontal equity," an important goal of our nation's tax laws. That is, the credit recognizes that families with the same income and family size who have employment-related, out-of-pocket dependent care expenses have less ability to pay taxes than families with the same income and family size who do not have such expenses. In order to promote "horizontal tax equity" between these families, taxpayers with employment-related dependent care expenses are given a tax credit to partially offset their dependent care expenses and thereby help equalize their ability to pay taxes. Among taxpayers who are eligible for its benefits, the credit also promotes "vertical tax equity," that is, provides greater benefit to lower-income than to higher-income taxpayers.

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[2] For example, a single mother with two children who has earnings of $10,000 and child care expenses of $1,000 for 1990 would be entitled to a dependent care credit of $300. Because she has no tax liability, however, the credit has no value to her. If the credit were refundable, she would be entitled to a refund of $300 (in addition to a separate earned income tax credit refund of $953).

The dependent care credit is the largest source of federal financial support for child care.[3] In 1989, the most recent year for which data are available, over 6 million taxpayers claimed the credit, and received over $2.45 billion in tax assistance. Most of this assistance went to low- and moderate-income taxpayers. Over 58 percent of the total went to taxpayers with AGIs under $40,000, 39 percent to taxpayers with AGIs under $30,000, and 20 percent to taxpayers with AGIs under $20,000.

Although a large number of low- and moderate-income families claimed the credit in 1989, both this number and the amount of credit received by these families has declined significantly since 1986. The most dramatic decline was between 1988 and 1989, when for the first time since 1976 both the total number of returns claiming the credit and the total amount of assistance received declined -- and declined not by just a modest amount but by over 30 percent. Moreover, these declines occurred at every income level.

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[3] IRS data do not break out the relative use of the credit for child as opposed to adult dependent care expenses, but most analysts believe the credit is overwhelmingly used for child care expenses. Moreover, other federal programs provide greater support for adult dependent care expenses.

These declines are attributable primarily to changes in the Tax Reform Act of 1986 (TRA) and the Family Support Act of 1988 (FSA) that have significantly affected the value of the dependent care credit, particularly for low- and moderate-income taxpayers.

Although the Tax Reform Act of 1986 did not alter the dependent care credit, changes in the overall tax structure made by the TRA affected the credit's value to low-income taxpayers. Since the TRA the dollar amounts of the tax code's basic provisions that determine individual tax liability -- the personal exemption, standard deduction, tax brackets, and, for low-income taxpayers, the earned income credit, have all been indexed for inflation. In contrast, neither the dependent care credit's sliding scale for determining the applicable percentage of expenses allowed as a credit, nor its expense limitations, are indexed. Particularly because of the TRA's failure to index the sliding scale or to make the credit refundable, its targeting to low-income taxpayers has been and will continue to be eroded as fewer and fewer taxpayers with AGIs low enough to take advantage of the maximum 30 percent credit have any tax liability. Indeed, since 1988, when tax reform was fully phased in, the tax thresholds for most married couples with children and heads of household (the majority of taxpayers with dependent care expenses) have been above $10,000 and for families of four or more have been above $12,000.[4] Thus few taxpayers whose AGI renders them eligible for the maximum credit of 30 percent of their qualifying dependent care expenses (taxpayers with AGIs under $10,000) have had any tax liability to offset since 1988. Moreover, this effect will continue to be aggravated over time as the components of the tax threshold -- the standard deduction and personal exemption -- increase with inflation.

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[4] For 1990 the tax thresholds of most married couples with children and heads of household will be approximately $11,000 or higher, and for families of four or more will be approximately $13,000 or higher.

The result of the TRA has been, as IRS data demonstrate, a decrease each year since 1986 in the number of taxpayers with AGIs under $15,000 claiming the credit, and in the amount they have received. In 1987 alone, before tax reform was fully phased in, there was a 27 percent decline in the number of taxpayers in this income bracket claiming the credit, and a 28 percent decline in the amount of assistance they received.[5] By 1989 the number of taxpayers with AGIs under $15,000 claiming the credit had declined by 71 percent, and the amount of assistance they received by 73 percent. The result has been a significant shift in the distribution of the credit: by 1989 only 9 percent of the taxpayers claiming the credit had AGIs under $15,000, compared with 21 percent in 1986, and they received only 7 percent of the total amount distributed in 1987, compared with 19 percent in 1986.

Changes in the dependent care credit contained in the Family Support Act of 1988 have resulted in an even more significant decline in the use of the credit and the assistance received from it for taxpayers at all income levels. This decline has been most dramatic for low- and moderate-income taxpayers. The FSA required that, beginning in 1989, all taxpayers claiming the credit provide the care provider's name, address and taxpayer identification number (TIN) on their tax returns; a qualifying child be under age 13 (lowered from 15); and taxpayers receiving tax-free dependent care assistance from their employers under a dependent care assistance program reduce by the amount of that assistance the amount they claim under the dependent care credit.

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[5] The number of taxpayers with AGIs under $15,000 who filed tax returns actually increased slightly between 1986 and 1987. Hence the decrease in the number of taxpayers claiming the credit during this period is not attributable to a decrease in the number of taxpayers with AGIs under $15,000.

The number of taxpayers claiming the credit with AGIs between $20,000 and $40,000 also decreased in 1987, by 11 percent, and the amount of assistance they received decreased by 4 percent. In contrast, the number of taxpayers claiming the credit with AGIs of $40,000 and above increased by 26 percent, and the amount they received increased by 31 percent. The result of these changes was a shift between 1986 and 1987 in the distribution of taxpayers claiming the credit and the amount they received -- over 66 percent of the taxpayers claiming the credit in 1987 had AGIs under $40,000, compared with 76 percent in 1986, and they received 64 percent of the total amount distributed in 1987, compared with 72 percent in 1986.

In March, 1989, taking into account these changes, the Joint Committee on Taxation estimated that approximately 8.5 million taxpayers would claim the dependent care credit for 1989, for a total of $3.7 billion in tax assistance. Preliminary IRS data for 1989, however, reveal that the FSA changes have had far greater impact than was estimated.

Only 6 million taxpayers claimed the credit for 1989, for a total of $2.45 billion in tax assistance. This was a drop since 1988 of 31 percent in the number of taxpayers claiming the credit, and of 34 percent in the amount of assistance received. Moreover, taxpayers with AGIs under $40,000 accounted for 76 percent of the decrease in the number of taxpayers claiming the credit, and 73 percent of the decrease in the amount of assistance received. In particular, the number of taxpayers with AGIs under $15,000 claiming the credit decreased by 47 percent, and the amount of assistance they received decreased by 48 percent. The number of taxpayers with AGIs under $40,000 claiming the credit decreased by 38 percent, and the amount of assistance they received decreased by 40 percent. In contrast, the number of taxpayers with AGIs above $40,000 claiming the credit decreased by 20 percent, and the assistance they received decreased by 24 percent.[6]

The Internal Revenue Service attributes the significant decrease in 1989 to the FSA requirement that taxpayers claiming the credit include the provider's name, address and taxpayer identification number. This requirement may have dissuaded taxpayers who had been improperly claiming the credit from continuing this practice. However, an equally likely possibility noted by IRS is that numerous child care providers who receive their income "off the books" may have refused to give the taxpayer a taxpayer identification number, thereby preventing the taxpayer from claiming the credit. IRS reports a 65 percent increase in the number of returns reporting income from child care services from 1988 to 1989, a fact which supports the theory that many providers had not previously reported their income but were prompted to do so as a result of the FSA's TIN requirement. IRS attributes considerably less of the decrease in 1989 to the two other changes in the FSA, the reduction in the age of a qualifying child in 1989 from under 15 to under 13, and the requirement that the amount of expenses used for determining the dependent care credit be reduced by the amount the taxpayer received tax-free under an employer-provided dependent care assistance program. Few taxpayers have child care expenses for older children, and few employers provide dependent care assistance.[7]

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[6] The shift in the distribution of the credit was more modest: for 1989, 58 percent of the taxpayers claiming the credit had AGIs under $40,000, compared with 64 percent in 1988, and they received 56 percent of the total amount distributed in 1989, compared with 62 percent in 1988.

[7] Preliminary IRS data for 1989 indicate that dependent care assistance was provided to 517,104 employees.

IRS acknowledges that further research is necessary to confirm the reasons for the dramatic decline in use of the credit for 1989. In our view that research should isolate each of the three changes in the credit made by the FSA, to determine the effect of each. In addition, it should include an analysis of the decline in the use of the credit by the lowest-income taxpayers as a result of the 1986 changes in the TRA, which each year are affecting low-income taxpayers at higher income levels. Finally, IRS should try to ascertain the extent to which the credit is used for child care and the extent to which it is used for adult care expenses, so that an evaluation of the decline in its assistance for each kind of care expense may be made.

Even before such research is completed, attention needs to be paid by Congress to the significant erosion in the credit's value. The dependent care credit should not continue to be pushed aside like a disfavored stepchild, while its popular sibling -- the earned income credit -- continues to grow, and the awaited new baby in the family -- some form of children's allowance -- is the new object of all our affections.

Tax proposals to expand the earned income credit or otherwise provide increased income support to families with children are important, and should be supported. But the dependent care credit serves a different purpose, that of helping families pay for their employment-related dependent care, and of assuring fair treatment in our nation's tax policies between families who have employment-related dependent care expenses and families who do not have such expenses. For these reasons, it should be retained and its targeting to low- and moderate-income families improved, as these are the families for whom dependent care expenses claim such a significant portion of their income. In addition, the credit's benefits should continue to be available to families at all income levels, just as other employment-related benefits given favorable treatment by our tax laws are available to taxpayers without regard to their income.

Accordingly, we make the following recommendations.

First, the dependent care credit should be retained and made refundable. Elimination of the credit, unless replaced by some other mechanism that effectively recognizes the need for assistance with dependent care expenses, would unfairly disadvantage families who must pay for dependent care in order to work. Moreover, proposals to convert the credit to a deduction are similarly unacceptable, because they would destroy the credit's targeting to low- and moderate-income taxpayers. Tax credits are generally more beneficial to taxpayers than a same-size deduction, and are relatively more beneficial to low-income taxpayers than high-income taxpayers.[8] The combination in the current dependent care credit of a sliding scale that provides the largest credit amounts to the lowest-income taxpayers and provides a tax credit rather than a same-size deduction renders the dependent care credit more valuable, both absolutely and relatively, to low- and moderate-income taxpayers than to higher-income taxpayers. However, unless the credit is made refundable, taxpayers who have no tax liability derive no benefit from the credit or its special targeting to low-income taxpayers, and other taxpayers lose the benefit of a portion of the credit they may claim.[9]

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[8] A credit is relatively more valuable to low-income taxpayers than to high-income taxpayers, since it offsets a greater proportion of the usually lower tax liability of low-income taxpayers. A deduction's value, by contrast, depends on a taxpayer's marginal tax rate, increasing as the marginal tax rate increases, which benefits high-income more than low-income taxpayers. A $100 deduction is worth only $15 to someone in a 15 percent tax bracket, but $33 to someone in a 33 percent bracket.

Second, the credit should be indexed for inflation. Neither the amount of dependent care expenses eligible for the credit, nor the sliding scale for determining the percentage of expenses that may be claimed, has been adjusted since 1981. As previously described, the effect of the lack of indexing has been exacerbated by the Tax Reform Act of 1986, which made no changes in the dependent care credit to take account of the TRA's indexing of other provisions, bracket changes and generally lower tax rates. Because many more low-income taxpayers since 1986 have no tax liability, virtually no taxpayers are eligible to claim the maximum percentage credits of 29 and 30 percent of their qualifying dependent care expenses. This not only reduces the amount of dependent care expenses that the lowest-income taxpayers may claim, it also reduces the amount that moderate-income taxpayers may claim, even when the only change in their adjusted gross income is the result of inflation. Over time, as the indexing of other provisions of the tax code raises the tax thresholds even higher and incomes continue to increase with inflation, the dependent care credit's percentage amounts, because they are not indexed, will become even more compressed, and its targeting to low- and moderate-income taxpayers even more attenuated.[10]

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[9] A bill to make the credit refundable was first introduced by Senator Kennedy in 1976, the time of enactment of the original child care credit legislation. Similar bills have been introduced every year since then. Most recently, in 1989 the Senate passed as part of the Act for Better Child Care a bill that would have made the credit 90 percent refundable, but the provision was dropped in conference with the House in late 1990.

Even making the credit refundable will not address a continuing concern about the credit's effectiveness for low-income taxpayers, who cannot afford to spend the amounts necessary ($2,400 or $4,800, depending on the number of dependents) to obtain the maximum credit. Additional low-income targeting of the credit to ameliorate the effect of the disparity in the actual dependent care expenditures of low- and high-income taxpayers could be accomplished by increasing the percentages at the lower end of the sliding scale, for example to 50 percent for the lowest-income taxpayers, with the highest-income taxpayers continuing to receive only 20 percent. For the last several years the Women's Economic Equity Act has contained such a provision, as well as a provision to make the credit refundable.

Third, despite the shifts in distributional effects of the credit's benefits, these effects should not be remedied by phasing out the dependent care credit at higher income levels.[11] Such a change would create the only income ceiling on tax assistance for employment-related expenses. The result would be that taxpayers at all income levels could deduct exclusive club memberships, luxury business cars and lavish office furnishings, but not the child and other dependent care that enables them to work. If Congress wants to limit tax assistance for employment-related expenses, it should impose an income limitation on **all** such assistance, not single out the dependent care assistance that is essential to so many families' economic livelihood.[12] And the distributional effects of the credit should be remedied by making it refundable and indexing it for inflation.

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[10] In 1989, only 9 percent of the taxpayers claiming the credit had AGIs under $15,000, compared with 21 percent in 1986, and they received only 7 percent of the total amount distributed, compared with 19 percent in 1986. Similarly, in 1989, 58 percent of the taxpayers claiming the credit had AGIs under $40,000, compared with 74 percent in 1986, and they received 56 percent of the total amount distributed, compared with 72 percent in 1986. If changes are not made in the credit, this significant shift in distribution of the credit's benefits from low- and moderate-income taxpayers to higher-income taxpayers will continue.

[11] In 1988, to help pay for the welfare reform bill, the House proposed phasing out the dependent care credit for families with incomes over $70,000. In response, Senator Bradley proposed instead phasing out the 80 percent meals and entertainment tax deduction for taxpayers with incomes between $360,000 and $400,000 -- incomes at the top tenth of one percent in the country. The Bradley proposal, which passed the Senate, was dropped in conference with the House, but so was the dependent care limitation. In 1989, as part of the child care legislation, the dependent care credit limitation was again approved by the House but dropped in conference with the Senate in late 1990.

Revisions in the tax code are of course only one means of providing federal assistance for child and adult dependent care. The Child Care and Development Block Grant and Titles IV-A and XX of the Social Security Act, which provide direct subsidies to help meet child -- and, in some instances, adult -- dependent care expenses of low- and moderate-income families, are also federal funding mechanisms that need to be strengthened. Nonetheless, the dependent care credit has an important role to play in helping families meet their dependent care expenses and in helping assure tax fairness between families with dependent care expenses and families without such expenses. Its continued erosion, which is having a significant and disproportionate effect on low- and moderate-income families, should be stemmed, and improvements made in the credit that will ensure its continued vitality.

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[12] In addition, as previously described, the dependent care credit is already structured to provide greater benefits for families at lower income levels and is not unlimited in amount. Depending on income, the credit is allowed only for 20 to 30 percent of dependent care expenses up to $2,400 for one dependent and $4,800 for two or more dependents.

Chairwoman **Schroeder**. Thank you very much.

I am so pleased you pointed out that the dependent care credit goes to handicapped adults, it could go to a spouse who had a heart attack, it could go to all sorts of different situations. It's very important to displaced homemakers and others who have to come back for different health reasons. So I'm really glad you pointed that out.

You know, having introduced the increase in the exemption in the early '80s, and here we are in the early '90s talking about it ten years later, maybe I should adopt your pedestrian view that nothing is going to change, Nancy. I'm not sure. But let's hope that it will change.

I am very pleased that this panel is here. Again, it's wonderful to see that broad-based support.

Let me announce that we are going to keep the hearing record open for two weeks, so that anybody who wants to add things to the hearing record before we send it off to some of the other committees to review, we would be more than happy to accept that, because I think that's a good idea.

I am also going to say I've been talking way too much and I'm going to yield to everybody else first before I ask my questions. So let me start sharing the podium. First of all, let me yield to our distinguished ranking minority member over here, Congressman Wolf. The floor is yours.

Mr. **Wolf**. Thank you.

I will just ask one basic question, or maybe a spin or two, and then not dominate the time. If all the panel could just kind of go down the line and comment one at a time.

Number one, I do think there is an opportunity in this Congress to increase the personal exemption. The reason I think there is an opportunity is that the bill that Congresswoman Schroeder and I are sponsors of was put in about three weeks ago and it has garnered about 59 cosponsors in not a very long period of time. We have a very diverse ideological, philosophical and geographical mix.

Secondly, I think the White House will be very understanding.

Thirdly, I believe it can be done within the confines of the budget package. The cost of increasing the personal exemption would be about $10 billion a year. With the CBO figures—and we're trying to work it out—it can fit in with what was done. So the few people that have been resistant to it have not been on the merits.

With the family being under such pressure today, with child abuse up, spouse abuse up, teenage suicide up, teenage pregnancy up—infant mortality was up and dropped just a slight bit, but still too high—I guess I would look at it as how can you afford not to do it? So the two questions I have is, one, if you can directly comment on the proposal to increase the personal exemption from $2,050 up to $3,500, with the goal that this ought not end for this decade but we should come back next year or the following year and try to go to $4,000 and $4,500, to meet the figures that Dr. Steuerle said it ought to be, around $7-8,000.

The second part of the question is if you would comment on the idea—and Mrs. Brennan mentioned it—of expanding the universal child tax credit to everyone, almost whether they're working or not working, or whatever, and if you were to do that, what age would you do that for? What age would that cover, up until what age for the child? So if you can cover those two questions, maybe very rapidly going down the panel.

Dr. **Steuerle**. Congressman Wolf, let me deal with the scond question first and then maybe get back to your first one.

If one were to provide a universal credit that we refund to everyone, I would consider applying it all the way up to age 18, or perhaps 16. Getting to your second question, I recognize that such a credit is expensive and one has to figure out how to pay for it.

My concern, as well as the concern of several members of this panel, is that, in part, we have a system where we provide welfare benefits for people who don't work or don't marry. Current AFDC might average, $2,000 per child. If the dependent exemption were increased substantially, it would also be worth, say, about $600–1,200 per child, if you're taxable.

The group that would get left out is in the middle, that's the reason many of us are thinking about going towards a credit—to have something like a refundable dependent exemption. The credit is what you're advocating here with the dependent exemption, only it's refundable so that there's no group in the middle that gets left out. This middle group doesn't qualify for AFDC because they marry or they work, so they don't get any of those benefits, and they won't really qualify for the dependent exemption very much, either, because they really don't have much tax liability. For them, the full benefits of the exemption would only be $100 or $200, if they're lucky.

Trying to make benefits more even and incentives for work and marriage better leads me more towards a credit these days, even though my work into the late Seventies and early Eighties raised this whole dependent exemption as a family issue. In effect, I think there is great justification for increasing the dependent exemption, but I think we have to worry about how the tax and transfer systems integrate together.

As to your first question, which related to how far would we go and how would we pay for it, it seems unthinkable to recall the experience of the Tax Reform Act of '86, whether people considered it a success or not.

As I said, in the late Seventies and early Eighties, when I first raised this family issue, most people thought it was a very impractical issue—for many of the same reasons that I'm sure the members of this panel are hearing today; that is, where is the money coming from and how can we possibly pay for this type of thing? I think the proposal does face that legitimate criticism. In the early Eighties, President Reagan, Senator Moynihan—people from all parts of the political spectrum—did come on board for increasing the personal exemption. But again, there was no way to pay for it. When we put the change into the context of tax reform, we were willing to make a lot of trade-offs—and pay for the increase in the personal exemption. As I said at the end of my testimony, we have to be honest, that trade-offs must also be introduced and considered. So it's very hard for me, in some sense, to answer your first question as to how far we can go and how quickly, because I think the real question is how many trade-offs are we willing to make at this point in time.

One way to finance a change is to start thinking about how we index many of our provisions in the tax and welfare systems. Over time we could increase this dependent exemption or provide a credit in place of an exemption, let it grow over time and gradually displace other programs if they were indexed to grow a little more slowly. That seems to me to be the trick. But it's not an easy trick. It's easy for me, you know, now sitting in a research institution as opposed to Government, to offer easy suggestions when I don't have to face the political ramifications of asking for those trade-offs.

Dr. **Shapiro**. Like everyone else, I certainly want to acknowledge the fact that Gene Steuerle has shown us the way on this issue for more than a decade, and we all owe him a great debt.

The question of what level to raise the exemption certainly addresses the basic issue of trade-offs, given a certain cost. I think the principle should be clear, however: that the Government not tax money needed to support children, which leads us to a figure of somewhere between $5,500 and $7,000.

The question of targeting, whether we target it by raising it first to a level of $3,000 or $3,500, versus a higher level initially for younger children, or a higher level initially for lower income people, there are arguments for each alternative. We tend to favor targeting to young children, on the view that this enables more mothers to stay at home in the crucial first years, following on more and more research findings that this is much to the psychological and intellectual benefit of children. In addition, targeting to young children intersects with the income question—that is, younger children tend to be the children of younger parents, whose incomes tend to be lower.

However, the most important thing that we can do is to establish the principle that the Government should reinforce the values of independent families; whether it does so initially through a $3,000 exemption across the board, or a $4,000 or $6,000 exemption for younger children. In either case we will have taken a great step.

Mr. **Bauer**. Congressman Wolf, we do believe that the ultimate goal ought to be to get the personal exemption up closer to $8,000. We realize it can't happen overnight. On the other hand, this whole process began back in the early Eighties, and as you know, during those years we were able to get through a doubling from $1,000 to a little over $2,000 now. I think your bill is a good next step, to get it up to $3,500, and I would hope in a few more years we could reach that $8,000 goal and bring it up to where it should have been in keeping pace with inflation since the end of World War II.

On the idea of a universal credit, I alluded in my testimony to the fact that we are tempted by that kind of an approach and we will probably have our own idea to put on the table down the road on that. If you're looking at costs, I think it makes a lot of sense to consider aiming such a credit in the beginning at least to preschool children and then determine how much more you can do given the fiscal realities.

I think these ideas, unlike a lot of ideas in Washington, have a hidden savings in contrast to the hidden costs that you often run into in this town. I think if you end up providing these kinds of breaks to families, they're going to end up having more money that they can save and invest and, in fact, end up being stimulative to the economy in a way that will probably end up helping tax revenues.

The only other thing I would like to point out is that while we've got an interesting coalition here supporting the idea, I think the coalition is in danger of unraveling fairly rapidly when you look at other ideas. For example, I had to restrain myself as I listened to the arguments about increasing the dependent care tax credit, which we already feel is unfair and discriminatory against those families who choose to have the mother or father stay home with their children instead of having two incomes. So I would urge the committee to stick with the subject at hand, where you do have a consensus that crosses ideological lines, and avoid going off into areas where that consensus will quickly unravel.

Ms. BRENNAN. I would like to affirm what has been said so far about the personal exemption. I don't think it needs any more bolstering. Our organization has been familiar with it since we began.

I would like to comment on the dependent care tax credit. I don't think I need to go into ideological or philosophical reasons at this point about why it is currently discriminatory. But I would like to talk about some built-in hypocrisy to the current system. That is, millions of American families, both dual earner and single earner, currently are not eligible for that credit. For example, I believe more than seven percent of families are "tag team" parent arrangements; that is, the mother and father share fairly equally income producing and child care between them. Those are families that are not currently eligible to claim the DCTC because they do not purchase child care.

Another example would be families where there is a home-based business that is either the primary or secondary source of income, mother or father. Again, this is the most requested piece of information from Mothers at Home, from both mothers who are at home now and are seeking ways to increase their income potential, and from mothers who would like to reduce their hours in the work force and would like to be able to generate home-based business opportunities. However, if they do that, in order to forego purchased day care, they will lose that dependent care tax credit, which sort of argues against it being a business expense. It is not a business expense.

The next group would be those who have flexible work hours. We see a lot of this. In fact, our organization hires several women to work part time, flexible hours, while their children are in school. They are not able to claim the DCTC, while others are able to by purchasing hired care.

The last group I think certainly is the focus of a great deal of deserved sympathy and concern by this committee and by this panel. That is single earner/parent families as a result of divorce. I would like to make some special comments about these because we, too, hear from those families.

First of all, there is no question but that the single earner family, the single parent family, is under stress. Divorce is a crisis that visits that family and it has profound effects. I think you mentioned that, Congressman, earlier in your opening remarks.

As a former crisis counselor, I would like to say that the primary point of crisis intervention is to stabilize and provide emotional support. A family undergoing divorce, like any other serious crisis, needs additional human resources to address that aspect. A family who is facing the separation of spouses is finding that the children need attention, and that attention is best served by the parent, whoever is custodial at that point. Maximizing time away from the child through a dependent care tax credit does not suit the crisis needs of that family.

I would like to comment on this because it was my personal experience. In growing up, my family was divorced, and due to the generous care of family members, we were able to receive a great deal of stability and support that allowed my younger sister and brother and myself to achieve our goals and become productive citizens. However, today my mother would not be eligible for that credit. I think when we consider what is tax fairness, we need to look at how it plays out in practice, not how we think it fits our philosophy.

Thank you.

Dr. SMEEDING. Mr. Wolf, your plan, if you go to $3,500 a head, pushes the point to which a mother, father and two kids start paying taxes to $19,000. That's $3,500 times four, plus the $5,000 zero bracket amount, $19,000. Right now, that point is $13,000. So for families earning between them about $6.50 an hour—that's $13,000 full time, a full year—and $9.50 and $10 an hour, or $19,000 a year, you're going to provide them with about $900 worth of tax relief. Instead, if you took this $3,500 and made it a refundable credit of $525 a head, it would be worth $2,100 to those same people.

Your plan of increasing the exemption to $3,500 does nothing for the working poor. At six bucks or six-fifty an hour, it's no different after you're done. You're already at $2,050 per head, exemption plus the $5,000, and it keeps them from paying any income tax right now. So you wouldn't be helping these people. You would be helping people who are between maybe $6 and $6.50 an hour and $9.50 or $10 an hour, but not a lot.

But you could help them a lot more. By the way, your exemption is helping me. I just had my fourth child the other day. But I don't need this help. If you give me $3,500 per child and did not phase it out, it is going to save me in New York—I just moved to New York from Tennessee, you're going to save me about 45 percent of that amount. Instead help somebody who needs it. That's the refundable credit plan.

The other question has to do with age. I like the idea of providing some sort of a credit for children up to age 5; I agree that we need something for the early formative years. It's very important. If we moved to a universal Head Start program or preschool program, like "ecole maternal" in France that would help. But just through the tax system to age 5 is where you need it. When the kids start going to school, you're implicitly providing some child support for kids, some implicit child care, because the kids are in school. So that's what I have to say about those two proposals.

Ms. **Campbell**. I, too, favor a credit-type approach, for essentially the same reasons that have already been described. Because I think you need to target more of the money on the lowest income families. I think really the most gripping problem that we're facing today is the number of families with children in poverty, and that these are the families that we need to give the most help to.

I think there are plans that have sort of a combination approach where you raise the personal exemption for adults and convert the personal exemption for dependents into some kind of a refundable credit, which then becomes more targeted to the lower end of the scale. So I think there are a lot of variations that one can look at.

The age of child is difficult. I agree with Gene, that if we had the money, it would be nice to go up to 18. But if we don't, we should keep it focused on the youngest children for some of the reasons that have already been described.

Let me just rebut the argument about the dependent care credit while I have the floor, the notion that this is a discriminatory credit. Again, the way the tax code works is, when you want to see how people pay taxes, you look to families that have the same income and the same family size and you see what each of them pays in taxes. Right now, under our tax code, if we did not have the dependent care credit for families that have out-of-pocket child care expenses—and I agree, it only applies to out-of-pocket expenses because those are what drain a family's ability to pay taxes—if you look at those families together, you will see that if we did not have the dependent care credit, families that have none of those expenses would be paying less taxes than families who have those expenses. So all the credit is doing is equalizing among those families, making sure that they pay essentially the same amount in taxes. It is not giving more to the families who are laying out the money to pay for child care. As I said, these are very high expenses relative to family income, particularly at the bottom income.

I am not urging that the dependent care credit be increased. I am urging that it not lose its targeting to low and moderate income families. When it was made into a credit in 1976, Congress thought that was important. In 1981, when it was changed so that more of its benefits went to the lowest income families, Congress thought that was important. All I'm saying is, if it stays the way it is, it will lose that targeting. Even if it isn't made refundable, if it is indexed, that will help to preserve that targeting.

Mr. **Wolf**. I thank you. I have no more questions.

I would just make one comment to the one gentleman. I personally support all the programs directed toward the working poor. I think that is clearly a very important thing. But there are also other people in the country, and there is so much financial pressure on the middle class that you're driving people—the studies show that parents are spending 40 percent less time with their children today than they did 20 years ago. I mean, the hassle and the pressure is so great. So what you want to do is do something by increasing the personal exemption to help those families stay together, to remove some of the pressure whereby moms and dads can spend more time with their kids. That's why I made the comment in my opening statement about values being not only taught but also caught. The more time that a mom or dad is with the child, the more you transfer your values.

We have a hundred and some programs directed toward the working poor, and I'm prepared to support the 105th, the 106th and 107th, because we really have a problem. But when I see the data on teenage suicides, teenage pregnancy, child abuse, spouse abuse, at the other levels, I'm just concerned that we have to do something to help those in the middle-income level, too. As the pollster was saying, they are really feeling tremendous pressure.

Again, thank you for your answers.

Chairwoman SCHROEDER. Thank you.

Congresswoman Horn.

Ms. HORN. I would like to explore two aspects here. One is the political acceptability, which Mr. Bauer mentioned, because I think that's critical. I'm a pragmatist and I want to get something done, but we know if it's acceptable throughout the range, from Pat and myself here, and perhaps the White House, I think we have a much better chance of having it get done.

Also, we must consider the revenue neutrality issue, of combining perhaps the increase in the exemption with a credit for the lowest end. I guess I am also concerned because I think nothing is going to be acceptable to any of us if it's not revenue-neutral.

I'm not sure who could best respond to these points. Perhaps Dr. Steuerle and Dr. Smeeding on that, and Mr. Bauer on the acceptability of a credit at the lowest end.

Dr. STEUERLE. I've been talking to people on all ends of the political spectrum about the notion of a credit and I'm actually surprised by the extent of its acceptability. In some ways, there's a game that's played, in calling a "tax credit" what is little different than a "family allowance". In fact, the difference is just a question of who administers the system.

I think most people recognize there are problems in our system, both on the tax side and the welfare side, and they are beginning to see how integrating these two together can make both systems better off.

The main beneficiaries of a credit are those of lower-middle income, or if you wish, upper-lower income say between $6,000 and $15,000, or $20,000 of income. They would be probably the primary beneficiaries.

Now, the reason they would be the primary beneficiaries is, that if you move way up the income scale, you're probably dealing; in some way or another with the people who are going to have to pay for a more generous child allowance. We have to be honest about it. We are trying to help families with children, but the money has to come from somewhere.

I'm really surprised at the extent to which a future tax adjustment for children has been accepted across the political spectrum. I think the debate is going to be less over the question of whether something like this is acceptable. Paying the cost of getting there, addressing the other issues of where we cut back and how we pay for a change—that's where the unity starts breaking down.

Ms. HORN. And it's hard to address that, is that it? What are your suggestions on how we pay for it?

Dr. Steuerle. Elsewhere, I have come up with some suggestions, but again I don't want to be wedded to these as the only way of proceeding.

I would maintain excise taxes at about the level they were, say, in the early Eighties. If we indexed them so that they maintained about the same proportion of income, that would be a substantial amount of income.

Removing the existing dependent exemption also gets you back some of the money if you replace the credit with an exemption. You can also cut back a little bit on AFDC and other benefits because you're going to have this credit replace those. That gets you back a little bit. Personally, I would also maintain what is really an effective top rate of about 34 percent. We supposedly have a statutory rate of 31 percent, but we have all these "bells and whistles" added on that really make it a 34 percent rate. This higher rate is supposed to fall in 1995, so I would just maintain it.

If we used all these adjustments, we could pay for about a $1,000 dependent credit.

Mr. Bauer. I would only comment that I think if you're looking for something that can get through this Congress, and can get White House support, I think you're probably better off in this round to stick with an exemption increase, even though it has some drawbacks. I think when you begin adding the credit and other things to it, you're going to get into larger and larger budget problems.

Down the road, if you're looking for an overall reform of the Tax Code to make the treatment of children, regardless of what income area they come from, fairer, then I think a universal credit across the income levels makes a lot of sense.

Ms. Horn. And have you any suggestions for paying the bill?

Mr. Bauer. No. This is one of those times when I'm perfectly glad to be a witness and not a Congressperson that has to find cuts to match new spending.

Again, I think there is probably less costs here than it appears at first glance. I do not think it is that difficult to find programs and other things in the budget that can be regulated in order to find the money for this. Our staff would be happy to sit down with yours to see if we could identify what some of those would be.

Dr. Smeeding. Miss Horn, first of all I have to answer Mr. Wolf, but it will answer you, too. If we go to a $600 a person credit instead of the personal exemption, first of all that helps families, by my rough calculations, up to about $35,000 a year. Those families are better off with the refundable credit than with the exemption.

People making $50-, $60-, $70- or $80,000 a year aren't as well off because they don't get the higher value, of a personal exemption, because their tax bracket is higher than the refundable credit.

The second thing is, if we had something like this that would cost us $120 billion, the way to pay for it is to do what other countries in the world do, too—tax all transfer payments as income. I would allow the elderly to preserve 15 percent of Social Security, which is roughly the amount that they contributed when they were younger working people, I would allow them to exempt that from tax. But I would tax the rest of it. I would tax unemployment compensation if you were getting it; I would tax AFDC if you happen to have moved into a high-income family, et cetera. That treats all income the same and all people fairly.

The refundable credit, Mr. Wolf, is just worth more to a middle-income family than your exemption. I mean, I like the idea of helping the middle class, but I think there's a better vehicle out there. That's all I'm trying to say.

Ms. **Horn**. Thank you.

I have no more questions, Madam Chairwoman.

Chairwoman **Schroeder**. Thank you.

Congressman McEwen.

Mr. **McEwen**. Thank you, Madam Chairman.

Everyone traditionally begins by thanking the Chairman for holding the hearings, but I am extremely grateful that you did this one, and I also want to congratulate Congressman Wolf.

From the information we have, it appears that in 1948 the average family of four paid about 2½ percent of their income in Federal income taxes. In the early Fifties it was 3½ percent, and today it is 24 percent, or a fourth. I submit that if one walked into the average family of four in 1952 with a machete and sliced a fourth of their income out from underneath the family, chances are the mother would have had to find a job, there probably would have been a massive increase in "latch key" children, chances are the children coming home from school to empty homes would have been delinquent, there probably would have been a tremendous need for day care, there probably would have been an increase in dropouts, and recognizing that if it went long enough and loud enough and far enough, Al Capone would have been able in the inner city to hire young grade school children to pack pistols to do his dirty work in his drug trade. Then Washington could throw up its hands and say, "Well, what we need to do is increases taxes to have more programs so that we can correct all these problems."

Many of us believe that the best Department of Health, Education and Welfare is the family, and that a mother and a father nurturing children can do more for improving educational scores and handling malnutrition from the consumption of junk food, which lowers hyperactivity in children in the neighborhood—and the list goes on and on.

It appears that one of the difficulties with this proposal is its simplicity. But I thank you for your testimony this morning. I am hopeful that we can begin to redress the steps that Government has made in its intrusion into the family and do as the First Lady of the World, Eleanor Roosevelt, had as her main crusade, the idea that mothers and women in this Nation would be able to choose whether or not they wished to serve in the work force or to serve their families at home. When people are poor, they don't have that option. The Government is doing a great deal to see to it that families, in the 1990s, are denied that option.

If I could ask you to comment, Miss Brennan, on the suggestion we heard, that by giving a tax credit to mothers who work outside the home, that that is equalizing the benefits to women. I didn't follow that exactly. I observed a certain misunderstanding between what Miss Campbell said and what you said, and I would like for both of you to try to help me there, if you could.

Ms. **Brennan**. Well, I think there may always be some disagreement, so I won't try to do that one. But I will address a couple of points.

First of all, the idea of horizontal equity is a very narrow concept. I think you cannot simply say this family earns this income and this family earns the same but has day care expenses and, therefore, their situations should be equalized by a credit. You have to look at a couple of different factors. One is how do they generate that income. It is not as if single-earner families or dual-earner families are exactly 100 percent single earner or 50–50 dual earner. There is such a variety, and certainly there is a variety of dependents in this situation. There is a variety of costs associated with where they live, what their family circumstances are, and are they supporting other dependents as well. So I think, to be honest, you would have to expand the notion of what kind of equity we're trying to discuss here.

The other thing that oftentimes gets missed is what do homemakers, or men at home, contribute to the overall productivity of the Nation in terms of unpaid work. One of the things we have been aware of certainly is that approximately 70 to 80 percent of mothers who are at home full time, or at home part time and at work part time, are major contributors in voluntary capacities in their communities. That being the case, that requires time, and that time, if not allowed, would have to be compensated for in some other way. So I think the tendency for us to look at those individuals, women and men, who forego employment as somehow not contributing to the taxable economy is a false notion.

I think it is difficult to understand because you can't measure that service. You can't say well, all people who forego income devote this much in terms of measurable productive units to our Nation's economy. But, in fact, that's what happens. As long as we intend to nitpick on the units of productivity, we're not going to get beyond that.

The second thing is that there is not this clear-cut dichotomy between mothers who are employed outside the home and mothers who are at home. They actually go back and forth in their roles. It is very common to find that at different times a family needs a certain amount of income or takes advantage of a certain opportunity, so that women may leave the home for a period of time, a few hours a week or 40 hours a week, 50 hours a week, to participate in the labor force. Certainly seasonal employees are a good example. Many home-based businesses are seasonal. So you can't say there are two separate groups with completely different needs. They actually mesh quite a bit.

I think the biggest drawback to the dependent care tax credit is that it does not address the fluidity between those groups. It assumes there are two groups, mothers in labor force and homemakers and that we have to separate out their needs.

Certainly there is great interest in this committee in the congressional body, and among policy groups, about what kind of parental leave policies would be existing in the future and how we arrive at those. The disincentive of the dependent care tax credit is to return mothers and fathers to the work force as soon as possible. It is very hypocritical to discuss parental leave opportunities, however they come about, and expanding time at home, and then say the only way the Government will support your time at home is to provide a negative tax incentive. The DCTC says that, while we think it's good that you nurture your children, we also think it's good for you to be employed as soon as possible, producing taxable income. So it is hypocritical to have those two policies (DCTC and parental leave) in place, one that reimburses child care expenses, and the other that says we think it's a good notion for you to spend time with your children.

That's all I would like to comment on at this point.

Ms. CAMPBELL. May I say something?

I certainly agree that there should be broader choices and that women and men, as well, should have choices about going into the work force or staying home with children. I think the problem is that none of the proposals that we have been talking about are going to yield enough money to produce a meaningful choice for these families. An extra thousand or two thousand a year doesn't make enough of a difference to most families about whether they have two parents in the work force or one. Of course, in a single-parent family, it doesn't make enough difference so that that person can stay home. So I think we do need more choices for families and we do need family leave policies that are far better than most employers have today. We do need more programs that will help to promote those choices.

But for the families who can't get enough income elsewhere to be able to stay home, and have to pay out money for child care, all I'm saying is that that should be recognized as an expense by the tax code.

Chairwoman SCHROEDER. Congressman Smith.

Mr. SMITH. Thank you, Madam Chairwoman.

You mentioned a while ago that the idea of raising the exemption has been around for 10 years, since 1981, and here we are in 1991——

Chairwoman SCHROEDER. It's been a lot longer than that.

Mr. SMITH. Right, and still nothing has happened.

The point I want to make is that in my judgment, it is going to be around for another ten years unless we address the threshold issue, which is how to offset the loss of revenue to the Treasury by raising the exemption, implementing tax credits or whatever method we might choose. Until we address that issue—and I know it's been asked by several of my colleagues already—I think we are ignoring the "trip" issue, the threshold issue, and until we resolve this issue, it does not matter how much we raise the exemption or how much we give in tax credits or whatever it might be.

I noticed in the responses to that question today almost all the panelists talk in terms of raising taxes of one sort or another. I don't think there's any member of this panel who believes any of the solutions offered in the way of raising taxes would actually pass this Congress, nor do I think realistically do we expect any of the relevant committees to implement a proposal that is going to generate losses to the Treasury by raising the exemption to $3,500 or having the tax credits.

One panelist, Dr. Shapiro, in his prepared remarks addressed the question of cutting spending and proposed a three percent cut in spending on personnel and administration. I would say, Dr. Shapiro, I like the idea of cutting spending, but again, I don't think Congress is going to cut personnel in the Government three percent across the board.

What I would like to do, Madam Chairwoman, is to call your attention to a resolution that I recently introduced, which also in a very short period of time has attracted over 50 cosponsors from both sides of the aisle. I offer this resolution for the panel's consideration and for our witnesses' consideration today as the most painless solution to the dilemma of how to offset the loss of revenue. The proposal I have made is that the Government, for one year, implement a ten percent cut in overhead expenses and then allow these costs to go up by the inflation rate for the next four years. That would save $27 billion the first year and $134 billion over five years.

Now, that is approximately twice what we need if we raise the exemption to $3,500, so for purposes here, let's call it a five percent cut for one year to offset the cost of raising the exemption. I think that is eminently doable because, when you talk about cutting overhead costs, you're not talking about cutting one person, you're not talking about cutting one program. What you are doing is talking about cutting the primary components of overhead, which are travel, printing and supplies.

In my judgment, it is almost painless, and certainly less painful, to say to the Government that you're taking nine trips next year instead of ten trips than to go to them and talk about raising taxes or cutting people. So I think this is eminently doable if we look in the right direction for the offset, and to me, the only solution that I have seen on the horizon deals with cutting Government overhead spending. I think that again is a proposal that should attract Republicans, Democrats, conservatives and liberals alike, simply because it is painless and simply because it would satisfy one side by cutting spending and it would satisfy the other by not cutting programs or people.

I would call that resolution to your attention. I have no questions, except that I hope you would take a look at that.

Chairwoman **Schroeder**. Thank you very much.

Does anyone want to make a comment on it?

Mr. **Bauer**. Yes. Congressman Smith, I would just like the record to show that the Family Research Council certainly doesn't advocate tax increases in order to come up with enough money so we can then turn around and cut taxes. That kind of game Washington does quite often and we certainly wouldn't recognize that as a good way to go.

I think your idea on overhead costs is a good approach. I don't have the figures at my fingertips, but I believe domestic spending in this fiscal year is going to go up by about ten percent. It seems to me there are places in the budget—and we're not talking about cuts, but just limiting the amount of growth to provide enough money to fund ideas like this, that would give funds to the children and families who need them.

Mr. **Smith**. Gary, let me follow up on that by saying something that my colleagues might also find interesting. Over the last 20 years, the overhead costs of the Government have gone up at twice the inflation rate and have never once been scrutinized by the Government. In fact, Government overhead is not even separated out in that four-inch thick budget book that we get. So it is an idea that has not been tried. It seems eminently practical to go to the Government and say to take fewer trips or print on both sides of the paper, if you want to save five or ten percent there.

But I honestly don't know of any other painless solution to come up with the revenue offset that we all agree, or at least I agree, needs to be addressed, before we can realistically start talking about increasing the exemption or tax credits.

Mr. **Bauer**. It's a good idea.

Mr. **Smith**. Dr. Shapiro, did you have a response to that?

Dr. **Shapiro**. Yes. Your approach is actually quite similar to the Progressive Policy Institute's. Our view is that broad-based tax relief for the middle class cannot be paid for through other taxes, because the only part of the tax base which would be large enough to pay for it is the middle class.

Mr. **Smith**. Right.

Dr. **Shapiro**. Consequently, we have to look at ways to reduce spending. Our approach is to take all of the administrative and personnel costs of Government and apply the rule to it, that each office, agency, and department has to achieve the same kind of annual productivity gain that any healthy business achieves, which is three percent a year. That's still a much lower rate, incidentally, than most healthy businesses in Japan, and a much lower rate than businesses in America which are under real competitive pressure——

Mr. **Smith**. At least we're talking about the same concept.

Dr. **Shapiro**. Right.

Mr. **Smith**. Madam Chairwoman, I wasn't going to do it, but since two panelists have already agreed with the concept, let me ask the other four witnesses what they think, very quickly, just a yes or no, in the interest of time, if they like the idea of cutting Government overhead spending. We could talk about percentages later on.

Dr. **Smeeding**. It sounds like a good idea, but then there wouldn't be as many people back there behind your seats telling Mr. Wolf and Mrs. Schroeder about what we're saying. [Laughter.]

Mr. **Smith**. Oh, no. You didn't hear what I said. Cutting overhead does not include personnel. It does not include personnel.

Dr. **Smeeding**. Oh. Excuse me. [Laughter.]

I think it's a great idea.

Mr. **Smith**. Maybe I was talking too quickly a while ago. But cutting Government spending does not include personnel or programs. It would not cut one individual, which is the attraction. That is why I think my colleagues on the other side of the aisle would be enamored with the idea. But other than that, do you like the idea?

Dr. **Smeeding**. Yeah.

Mr. **Smith**. Okay. The other three, if you all would give me a quick comment.

Ms. **Brennan**. Mothers at Home would be thrilled, period.

Mr. **Smith**. That's four for four. Okay. Let me try the other two.

Ms. **Campbell**. It sounds fine.

Dr. **Smeeding**. Mothers working would like it, too.

Dr. STEUERLE. I don't know how anyone can object to cutting overhead spending. The real trick, of course, is coming up with a rule that doesn't cut out the good anti-missile missiles at the same time you're cutting out something that doesn't work. That's not overhead, but——

Mr. SMITH. Again, the $27 billion I was talking about for the first year doesn't come from one program, it doesn't come from cutting one employee of the Federal Government. It comes from cutting such items as printing and travel and supplies, all of which have, as I said, increased at twice the rate of inflation for the last 20 years and have gone unscrutinized.

I thank you all. I didn't expect to get six for six. I appreciate it.

Madam Chairwoman, I will yield back.

Chairwoman SCHROEDER. You're on a roll. I've never seen such unanimity.

Congressman Hastert.

Mr. HASTERT. Thank you, Madam Chairman. It is certainly timely in bringing this issue forward. I certainly salute you and it is time that we talk about reducing taxes.

I think it is important that we look at the issue of what families are, and the values that families have traditionally provided this Nation ever since its inception. We have gradually moved away from the centralized family, not because people wanted to but because we haven't given them choices and other options. They have been forced into choices sometimes because of congressional shots in the dark. The fragmentation of programs forces families to disintegrate and split apart.

I think one of the things we can do on this select committee is to highlight what is important for the American family. It's a fine line between family tax policy and welfare reform. We need to be careful not to get the two mixed up. We need to look at what the tax programs and tax policies in this country have done over the last 40 years to families, just as we also need to look at what they have done to senior citizens. For instance, you look at the tax policy that forces people to retire when they reach age 65 instead of continuing to work. We have tax policies that sometimes force people to consider alternatives that threaten the well-being of their family.

So, with that in mind, I would like to ask Mr. Bauer what are some of your views. You talk about the unique social value of children and of bringing children up in a family unit. While this is a moral issue, I believe we need to recognize the worth and dignity of every child by providing tax benefits to every child. I mean, I don't know if we can afford it, but how does that play into this?

Our strategy should seek to keep families together, to keep families unitary in a sense—and that might be multigenerational. With this in mind how do you see us starting to structure a tax policy that strengthens that?

Mr. BAUER. Well, it's a tough question. We could probably spend the entire afternoon on the answer. I suspect again that we're probably on tricky ground, that we will get a lot of disagreement.

I noted with interest a little earlier the comment comparing the United States to countries in Europe and Canada, as far as the number of children in poverty. At least part of the reason for those differences is what has happened to the family. I would suspect that if you look at those European countries, or if you look at Canada, you do not see the kind of failure of families to form as we are experiencing in our inner cities, nor the degree of family breakup as we see across our society today. That, of course, is the main reason so many children are being born into poverty. If they are being born out of wedlock to single parents, they are predictably going to become statistics in new poverty households.

So we do feel very strongly that, while this idea is a very good one and ought to be pursued, we also ought to look at welfare programs and see to what extent those programs have discouraged families from forming and have made it more difficult for inner city families to stay together as a family unit. I think there are some interesting things that could be done in that whole area.

I think as a society, again, whether we're conservatives or liberals, we need to start elevating the idea of parenting to its rightful place in society. I'm as pleased as anyone—I have two daughters, and I'm as pleased as anyone at the new degree of opportunities that women have in our society. I think it's good that you can pick up the newspaper and see an article on the style page of any major newspaper in the country singing the praises of a woman that has become the first vice president of this company or that company. I think that deserves to be praised.

But there are millions of women who are devoting their lives to being at home raising children. They get very little attention in our society. They don't see role models on TV in many cases to model themselves after. They don't see politicians saying very much about them.

I think that, as a society, we need to elevate parenting, whether it's done by a mother or a father, back to the level is deserves to be in our overall culture. So I think all these things can do a lot to move the country back to the kind of country that is family-friendly and children-friendly. And while a lot can be done in Congress, I suspect a lot of the other more important things are cultural things that we need to address as a society.

Mr. HASTERT. Well, we know that many times Federal policy drives with either a carrot or a stick what becomes social policy in this country.

Madam Chairman, I certainly salute you in having these hearings today. I wish you would have been able to include Chairman Rostenkowski to hear this discussion because ultimately he will have a hand in how this develops.

I believe there is a value of having two-parent families raising children—I come from a rather affluent community and district, although we certainly have our share of families in poverty, I talk to middle class families, people who have good jobs, working at $16 and $20 an hour jobs. Mothers are still forced to go into the work force, not because they want to but because, economically, if they want to provide for the education of their children after they get out of high school, or if they want to take that family vacation, that's important to a lot of people's belief, or if they want to achieve more of the American dream by moving from a rental property to owning their own home, then they have no choice.

This is the economic reality that confronts American families today—it is one that gives parents very few options—mothers included. With this in mind, is there a policy and straegy that maybe we can agree on to keep the family unit together.

Mr. **Bauer**. I certainly hope that such a consensus is forming. I think the fact that you've got the kind of support for this idea that we see in the room today, although probably all the witnesses here will go out in the hall and disagree on the time of day, we do agree on this idea of being a good first step to provide the kind of atmosphere that you're talking about.

I think there is a merging consensus. I think it transcends ideological lines and political lines, and I, quite frankly, think that the politics of saving the American family is going to be the politics of the '90s.

Mr. **Hastert**. Dr. Shapiro, would you care to comment on this idea of the two-parent, one earner family?

Dr. **Shapiro**. Yes. In the last ten years there has been a revolution in research findings as to our understanding of the effects on children of the deterioration of the family, of the traditional family unit. I'm an economist and I look at these things as functional distinctions rather than moral distinctions, though they also may be that.

What we have found, of course, in pure economic terms, is that the best predictor of the economic circumstances of a child is whether there is one parent present or two. That is, in fact, a much stronger predictor than whether there is one earner or two; that is, the family incomes of two-parent families in which only one parent works are equal to about 67 to 87 percent of the family income of two-parent families where both work, whereas the income of one-parent families is equal to only 35 to 45 percent of the average income of the two-parent, two-worker families.

Now, the major reason for that, of course, is that most single-parent families are headed by women and women earn less.

But, in addition to the fact that the greatest predictor of whether or not a child is poor is whether there is one parent or two—and we should note that in two-thirds of those cases in which there is one parent, the reason is divorce, not a mother never having married—the revolution in one-parent families in America is being driven by divorce. Fifteen years ago there were five million American children in one-parent families because of divorce, and today there are nine million.

In addition, the latest research has shown that, the academic achievement of children from two-parent families is higher than the academic achievement of children from one-parent families of the same income. That is true in low-income families and it's true in high-income families based on a new study of over 14,000 children in America. One or two parents is also a factor, to a statistically significant degree, in rates of childhood suicide, of drug abuse, and of delinquent behavior.

The problem, of course, is, how do we keep families together in the interest of children without penalizing one-parent families—and most single parents work desperately hard to provide for their families—and without reducing personal freedoms that everyone acknowledges are important. I think the answer is, we have to change attitudes more than laws. We have to educate people about the effect on their children of their failing to make their relationships work.

I have one other comment, and I'll keep it very brief.

Even if we change attitudes, there is something else happening in America to children and families, and that is a startling slowdown in the growth of the American economy—in particular, in the productivity gains from which income gains ultimately derive. Even if we change the attitudes of Americans towards the importance of two-parent families, that will not be enough for the vast majority of the country which now is unable to see its incomes increase even with both parents working. That is, we also must address the basic economic problems facing the country and make the kinds of investments that are necessary to get productivity going again.

Mr. **Hastert**. And you have no easy answer on how you, in fact, educate those people, obviously.

I think you're on point, and I don't know what the answer to that is, either. As a child of the '60s, the society emphasized the "me first" belief. And after 30 years we now are seeing the detrimental disintegration of the family. Many families in my district have split into two single-parent families. They live with one parent one part of the week and the other parent the other part of the week. Many children suffer in such situations. There isn't consistency or a family unit with two people trying to guide the destiny of a family. I think that's something that is sorely lacking. When you start to look at our society as compared to the Europeans, they always have their support. I think that's a real difference.

I certainly appreciate all of your testimony here today. Thank you.

Ms. **Brennan**. Congressman, excuse me, if I could just comment.

I want to commend your points made today. I think they're very important. First of all, one day we discussed in our organization the perpetual media myopia when it comes to family issues. Something that writer Karl Zinsmeister said in a Washington Post op-ed piece is "that a woman is more likely to get attention for writing a catchy new ad campaign for toothpaste than she is for creating and developing an original personality."

We find that parents, regardless of their work-home choice, have a tremendously limited access to the cultural discussion—Whether it's through the media, or to their elected representatives—not necessarily just at the national, but at the local and state levels as well. It may take a full six weeks for a mother supervising a toddler or an infant to write a letter to her Congressman, and it's going to have graham cracker crumbs on it and she may be embarrassed to send it. Families have difficulty getting access to policy discussion.

I had to think about my getting here today. It was a different set of circumstances as a mother at home than it would be if it was my paid job to be here, which it is not. Therefore, I think you have to look at how do families have an opportunity to discuss family issues. They are left out of the discussion. Again, I want to thank the Chairwoman for making this a possibility for us to speak out.

The second thing is what all the panelists are alluding to, that while legislation is important on taxes, and it's significant and we don't want to underestimate that, leadership is as much a part of this as legislation. Leadership transcends the issue of tax legislation—cultural leadership, personal leadership. I think that each person here, in their own way, can move that cultural debate. I think we have to do it. Again, I don't think it's easy, but just knowing that there's a commitment to it is very important.

The other thing I would like to say is that we're not discussing economics and taxes in a cultural vacuum. For example, There is a cultural sterotype that there are distinctly modern marriages and traditional marriages. I have always found this rather confusing because I think I'm both in a modern and a traditional marriage. I might note that my husband is here today, listening very carefully to what I have to say.

But women and men still hold on to enduring values about families. How they organize their lives does not necessarily change what they care about and the commitments they make to having and nurturing children. If a circumstance like divorce comes up, it's not a lifestyle you have chosen. My mother did not choose a lifestyle, and I did not grow up in an alternative lifestyle. We still had an enduring sense of what family meant—love, commitment, time, values of education, and that didn't change because of our circumstances. And remarriage, if that occurs in a family, does not change traditional values. So we need to get beyond this concept of a modern, progressive notion of a family and a traditional, non-progressive family.

Again, referring back to what Mr. Bauer said, the opportunities for women have been significant, and they should have been able to free us to do more with our spouses and our families; yet, we're hindered by the current economic conditions as promoted by the tax policy of this country.

Chairwoman SCHROEDER. Thank you.

Mr. HASTERT. I think you make a valid point. But I think also that people ought to have choices. A lot of people are being forced to work today and forced to leave the traditional family, not by choice but because of economic necessity.

Chairwoman SCHROEDER. Absolutely. Thank you very much.

Dr. Smeeding, let me ask you a question about the Luxembourg study. As you look at these other countries and compare, do you also look at what families get for their tax dollars? I know you mentioned France and the dependent credit——

Dr. SMEEDING. Sure.

Chairwoman SCHROEDER [continuing]. And all of that. My understanding is, that in France, 97 percent of the three-year-olds are in full-time school.

Dr. SMEEDING. For three- and four-year olds, they're in "ecole maternal." They have a universal preschool program which benefits all mothers. That's why their tax deduction for working mothers only goes to age three.

Why Luxembourg? It's just that Luxembourg was willing to pay some crazy academic to spend half of his life making this data comparable so we can talk about it.

Our two-parent families do a lot worse than the two-parent families in other countries, too. The most interesting comparison, though—and I urge you to look more deeply into this—is the Canadians. You don't have to go all the way to Europe, and we're not talking about making this country like Sweden and things like that, which scares people. But look at the Canadians, their beer is a little better, and their heating bills are a little higher, but otherwise—and they have one crazy province, too, and I won't say which crazy state we've got—but they are pretty much the same as we are. Over the last ten years they have managed to lower the poverty rate of their children and provide more support to families, to lower the poverty rate of their elderly, particularly for widows living alone, and they have done this through a combined tax transfer policy that involves subsidizing children wherever they happen to live, whether their mothers work or don't work, through the sort of refundable credit type system that I recommended earlier. It only makes sense.

I agree with your 104 programs point. That's why we have an Earned Income Tax Credit, and a credit for Mr. Benston—to buy health insurance. Health insurance is another thing, of course. Every other country that we're looking at here has a system that guarantees that everyone has access to basic services.

Chairwoman SCHROEDER. That's one of my points. When you look at what families in other countries get for their tax dollars, and then you take American families and their tax dollars and what they don't get, and what it costs them to go buy it, you really then get a double whammy as to what this whole stress level is.

Dr. SMEEDING. No doubt about it.

Chairwoman SCHROEDER. As we look at that slide on the table over there again, you look at 1948, and over 40 percent of the income isn't taxed, and then boom, you're down the slide until you're way down at the bottom.

I know we have had a lot of discussion about the $35,000 and below and how the credit would do a lot for them. But if we go back to Celinda Lake's opening statement, one of the things that American families seem to also be terribly worried about is college education—you know, wanting the IRA's for college education. I think that's one of the main reasons that women often give for having to move into the workplace and on and on and on.

So I think that increasing the exemption again helps with that whole college education thing, too, and that's a very important part of our remaining competitive. I guess the frustration is that so often people have this feeling that Democrats only want to give their money to the poor and the Republicans only want to give it to the rich, and they're in the middle and being taxed on both of these things. I think to some extent that's what that slide is about. The middle class has really been impacted by an awful lot of these programs, some right and some wrong, and yes, we should try to figure out how to pay for them. But it really has put on a lot of pressure. It goes back to the very important study that the Progressive Institute was talking about, too.

There is another part that I've read, that you're much more apt to have a divorce in a low-income family than a high-income family, because Americans basically want to be successful, and they get into this family mode and find out it's costing them a bloody fortune. So one or the other runs and the other one is left trying to pick up the pieces.

I think that came out this weekend, didn't it? Did you release that?

Dr. **Shapiro**. No. The PPI did hold a forum on the problems of the family last Friday, and we have released a report on putting children first in an attempt to reformulate a progressive family policy centered significantly around the exemption as well as a set of other proposals.

Chairwoman **Schroeder**. But basically there are some new studies out showing that divorce is driven a lot by the economic status of the family.

Dr. **Shapiro**. Absolutely.

Chairwoman **Schroeder**. And then relative economic status of single and——

Dr. **Shapiro**. Oh, yes. Part of it, of course, is that high-income families are under less economic stress. In addition, upper-income families tend to have married a little later, which may be a factor, and upper-income families in particular can afford a lot of support services which can help them get through difficulties in their relationships which, as we all know, are inevitable.

Chairwoman **Schroeder**. I think that's so important, because one of the things we want to keep in mind as we look at increasing the exemption, that hopefully any help economically you can get for the middle class you also maybe help the divorce rate, even though I realize it's hard to legislate.

Dr. **Shapiro**. Yes. Also, I don't think that we should dismiss the impact of public education.

Chairwoman **Schroeder**. I think that's true.

Dr. **Shapiro**. We have had several very clear examples where it has had a significant impact. In highway safety, for example. The United States has the lowest fatality rate because of a 30-year public highway safety education program. Public education seems to be having some effect on drug use in America. A massive public education campaign through the 1950s and 1960s was a principal factor in turning the Japanese from a low-saving to a high-saving culture. I don't think we should overlook the potential of that.

Chairwoman **Schroeder**. Dr. Steuerle, I was so pleased that you addressed the marriage penalty and said don't marry, it costs you a lot. I remember when I first got here, we wheeled a wedding cake into the Ways and Means Committee and said, "Do you want to know what this cake really costs the average family?" We pretty much took care of it with the upper income, but I think your points about the lower income are really incredible. Those statistics are fairly devastating. As you try to work yourself off the bottom rung, you get hit coming both ways.

Dr. **Steuerle**. I think that's correct, Madam Chairwoman.

Again, I think it was an indirect result of other policy decisions. I don't think it was an intentional result. The problem derives from not worrying about how different programs integrate and fit together. But the tax rates faced by these lower- and middle-income people and the marriage penalty that is faced by them—especially as they move to a job and away from welfare—are far higher than we impose on any other segment of society.

By the way, we do have some marriage penalties in the tax code, but I do think in the Tax Reform Act we managed to mitigate or lessen them a bit. It's down at the bottom of the income distribution where they are clearly the highest at this point in time, both relative to income and even in absolute dollars.

Chairwoman SCHROEDER. Down at the bottom where we're the most concerned about young families getting a good start, and we're penalizing them the heaviest.

Dr. STEUERLE. You know, the literature is mixed in terms of the incentive effects of a lot of the issues we're talking about. The literature does say where the disincentives are likely to have an effect is on marriage. For instance, if we're looking again at the welfare population, the incentive effects do affect marriage rates. Now it is not clear that the types of changes we're discussing would have a dramatic impact on out-of-wedlock births. The United States is not the worst internationally. Some countries like Sweden have far higher percentages of out-of-wedlock births. But after those births take place, at least in some of these countries there is a greater tendency to marry. There is some evidence that these high tax rates really do have an effect on marriage rates. Individuals with out-of-wedlock births face a large marriage penalty, and over time gradually that penalty has had an effect on the extent to which they do marry.

Even if we didn't believe that marriage penalties had an incentive effect, I just think the unfairness of the situation still must appeal to our sense of justice.

Chairwoman SCHROEDER. Do you have any solutions you could give the committee—or maybe you would want to do it in writing later on, but I think we're going to try and distill some of this down for Ways and Means. Is there any quick fix to that, or is it systemic?

Dr. STEUERLE. My proposed "fixes" are not quick. Again, I think one of the basic problems is the question—it's a technical issue—of how to phase out or tax away benefits as income increases. The way our tax and welfare systems have tended to work is that, if you marry or you work, your before tax income goes up. So we quickly say, "Ah ha, you don't need any of these benefits." The notion has been to save money by making programs less universal. But we have tried to save so much that we've imposed these very high—one-hundred percent— tax rates on many people.

Suppose we move towards a universal type of tax credit that doesn't phase out as income increases and that displaces programs like AFDC, which does phase out quickly. Then we move to a world where, if you moved to a little higher income, you work a little more, or you happen to marry, you don't lose all of these benefits. You don't pay these tremendous tax rates.

Another proposal, which is certainly not original, is to try to collect more money from the absent parent. If you think about it, this proposal also works toward reducing the marriage penalty. If the parent is going to pay, whether absent or not, then there is less of a disincentive for marriage. If we could collect more through that vehicle, again we would displace some of our programs like AFDC.

That would reduce the penalty from working. A parent taking care of children would have the money from the absent parent regardless of whether she or he worked or married again. So better child support from absent parents also tends to work in the direction of reducing these penalties.

Chairwoman SCHROEDER. I won't ask anyone to comment on what I always go around saying, because I realize the cost of it would be off the charts. But I have always thought that if we treated families more like we treated corporations and gave everybody an $8,000 personal exemption, that if you didn't have enough income for all the exemptions, you could go sell it to someone who did have the income. You could make entrepreneurs out of all sorts of families and you could cut out all sorts of Government programs. It could be very interesting, but people are horrified when you mention it. It is a concept that is kind of amazing, as we listen to Congressman McEwen and other people talk about it.

I want to thank both Heidi Brennan and Nancy Campbell for talking about women in the work force. You know, the Census Bureau now tells us that nine out of ten women will have to be in the work force at some time during their life because of the economy, not because of the Equal Rights Amendment—it didn't pass—but because of the economy and the fact they want to live at a middle-class level.

So I think we have to be very mindful of how we make part-time work much more professional, and we haven't. As a society, we have tended to treat part-time work like it didn't count, volunteer work like it didn't count. It should be deductible, and IRAs for people who want to stay at home and on and on and on, the whole level of those types of things.

But I hope that we can keep focused on the fact that we should again give people choices, and when nine out of ten are going to have to work at some time during their life, it is really not choices for a large majority of the people. Again, hopefully, if we can all come together on an overall tax policy, lifting the burden, at least giving a few more percentage points choices or whatever, and work on some of the ancilliary issues, too—I know a lot of the hearing has gotten into other ancilliary things, but I hope we can keep focused more and more on the tax thing, saying if we could lift that burden off a few people, so that a few more people have choices, it could be very helpful in the long run.

I want to thank all of our witnesses, actually, for all of you being here. Does anyone else have further questions before we close out?

Ms. HORN. I would like to thank everybody also and thank the Chairwoman for calling this hearing.

Mr. WOLF. Let me also thank Congresswoman Schroeder for holding this hearing. I think it is one of the first hearings since I've been in Congress dedicated exclusively to the tax code and families and not to some of the other special interests, albeit perhaps many times good interests in the country.

It is good to see the whole panel basically come together. There were some differences, but they really weren't major differences. As Mrs. Schroeder said, too, I think the choices are important, and flexitime or flexiplace is perhaps the subject of another hearing, and job sharing, leave sharing, telecommuting, and a lot of other things like that which, quite frankly, the Federal Government has been a leader in more than in the private sector.

My own sense tells me there will be a tax bill this Congress. It will probably be in the second session. A lot of the programs are expiring. The question is, will it help the family or will it help other groups who are powerful and can hire law firms like Akin Gump and some of the other big firms in town? That's the real question.

My last comment is, I saw Heidi Brennan's statement where she says, "Our Nation has become enthralled"—and I would just change it to say our Congress as well as the Nation—"has become enthralled with every social program conceived except the one that has sustained us throughout history—the family. A fair and equitable tax system must support the family as the most important socioeconomic program to a healthy, democratic society." I think that probably says it as well as anything.

I just hope that we can continue, as everyone leaves the room, to be singing from basically the same sheet of music, because there will be an opportunity and I think the press will listen and Members of Congress will listen—I plan on sending more "Dear Colleague" letters out on this issue—and all of you together, quite frankly, have probably forgotten more about this issue, particularly the tax code, than I understand. But you have made a tremendous difference.

I have read the Progressive Policy Institute's study, I guess about three or four months ago, and you could have ripped off the cover and it could have been done by Gary Bauer's group. I mean, it was very good. And to see the connections——

Mr. BAUER. Congressman, that's what they did. [Laughter.]

Mr. WOLF. I would say not quite the same. But it is a coming together and that is very important, too.

I want to again thank all of you.

Mr. HASTERT. Madam Chairman, I too would like to thank you for bringing this issue before us. It is certainly timely and crucial. we must work to discover some road, some agreement, that is right, so we can start to structure other Federal laws to support the family.

I would ask, too, if we would be able to submit questions in writing, that the panel would respond to that.

Chairwoman SCHROEDER. Absolutely.

You are all very patient and have given generously of your time. I know there are a thousand other things you would all like to say, so feel free to submit them for the record. We are going to stay on this issue, and we're trying to become, I guess, the lobbyists for families here as tax policy unravels and unfolds, as the new tax thing comes through.

If we keep reminding families, when somebody keeps coming up with new ideas for tax benefits, would they rather have that or would they rather have a little family relief, I think when you start putting it in that context, we're going to win many more fights. So if we can stay united, I think we've got a real chance.

I thank everyone for participating and, with that, we will adjourn the hearing.

[Whereupon, at 12:20 p.m., the hearing was concluded.]

[Material submitted from inclusion in the record follows:]

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April 30, 1991

C. Eugene Steuerle, Ph.D.
Senior Fellow
The Urban Institute
2100 M Street, N.W.
Washington, DC 20037

Dear Dr. Steuerle:

I want to express my appreciation to you for appearing before the Select Committee on Children, Youth, and Families at our hearing, "Reclaiming the Tax Code for American Families," held earlier this month. Your testimony was, indeed, important to the work of the Committee.

The transcript is now being prepared for printing. It would be helpful if you would go over the enclosed copy of your remarks to assure that they are accurate, and return the transcript by May 10 with any necessary corrections.

In addition, Representative Joan Kelly Horn has requested that the following questions be directed to you for inclusion in the record:

1. Would you go along with the 10% overhead cut proposed by Congressman Lamar Smith?

2. What are your views on combining an increased exemption like that proposed by Congressman Frank Wolf and a tax credit like suggested by Dr. Timothy Smeeding?

Again, my thanks, and that of the other members of the Committee, for your participation.

Sincerely,

Pat Schroeder

PATRICIA SCHROEDER
Chairwoman

PS/jg
Enclosure

RESPONSE TO QUESTIONS POSED BY CONGRESSWOMAN JOAN KELLY HORN

1. **Would you go along with the 10% overhead cut proposed by Congressman Lamar Smith?**

   I would support specific cuts in overhead, although I am uncomfortable with a simple across-the-board cut that might operate like the old, hard-to-apply sequestration rules in the budget.

2. **What are your views on combining an increased exemption like that proposed by Congressman Frank Wolf and a tax credit like the one suggested by Dr. Timothy Smeeding?**

   For administrative reasons, I would prefer simply to have a single credit mechanism. Certainly, however, a higher exemption can be justified.

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U.S. House of Representatives

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CAROL M. STATUTO
MINORITY DEPUTY STAFF DIRECTOR

TELEPHONE 202 226-7692

April 30, 1991

Gary Bauer, President
Family Research Council
700 13th Street, N.W., Suite 500
Washington, DC 20005

Dear Mr. Bauer:

I want to express my personal appreciation to you for appearing before the Select Committee on Children, Youth, and Families at our hearing, "Reclaiming the Tax Code for American Families," held earlier this month. Your testimony was, indeed, important to the work of the Committee.

The transcript is now being prepared for printing. It would be helpful if you would go over the enclosed copy of your remarks to assure that they are accurate, and return the transcript by May 10 with any necessary corrections.

In addition, Representative Dennis Hastert has asked that the following question be directed to you for inclusion in the record:

> How would the proposals for tax reform made by the other witnesses fit with the five principles for tax reform that you have advocated in your testimony?

Again, my thanks, and that of the other members of the Committee, for your participation.

Sincerely,

Pat Schroeder

PATRICIA SCHROEDER
Chairwoman

PS/jg

Enclosure

RESPONSE TO QUESTION POSED BY CONGRESSMAN J. DENNIS HASTERT

I think it is clear there is broad agreement on the first principle that Congress restore pro-child tax benefits to their 1948 level. I also think there is broad agreement, at least on a rhetorical level, on the need to target relief to middle-income parents (although I fear some may want to increase welfare under the rubric of pro-child tax relief.)

While Heidi Brennan is the only other witness who specifically addresses the bias against parental childrearing in written testimony, I am encouraged that Dr. Smeeding points out that tax benefits tied to day care expenses are quite unusual from an international perspective and that Dr. Shapiro underscores the importance of parental time with children in his oral remarks.

As these comments suggest, I think there is a growing consensus on this issue, especially if -- as we suggest -- tax benefits linked to day care expenses are replaced by benefits offered to all taxpayers with children. That is precisely the approach the Soviet Union took last year and there is no reason we cannot do the same thing here in the U.S. Indeed, it would be a huge mistake for policymakers to convert the dependent exemption into a new tax credit without also rolling the DCTC and DCAPs into this new credit. Let me add as well that an attempt to eliminate the Young Child Tax Credit would be a serious breach of this principle since the YCTC was created to partially address the tax code's existing bias against parental childrearing by specifying that taxpayers must choose either the YCTC or the DCTC, but not both.

On the fourth principle, I am not aware of any other witness who is proposing a new benefit for low-income two-parent families, but I hear nothing from the other panelists which would argue against such a proposal.

Finally, the principle of separating tax relief from cash transfers argues against child allowance proposals which offer $1,000 per child to families whether or not they have income. Even if AFDC modifications are made, there is reason to distinguish between tax relief and wage supplements.

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April 30, 1991

Timothy M. Smeeding, Ph.D.
Professor of Economics and Public Administration
Metropolitan Studies Program
400 Maxwell Hall
Syracuse, NY 13244-1090

Dear Dr. Smeeding:

I want to express my appreciation to you for appearing before the Select Committee on Children, Youth, and Families at our hearing, "Reclaiming the Tax Code for American Families," held earlier this month. Your testimony was, indeed, important to the work of the Committee.

The transcript is now in being prepared for printing. It would be helpful if you would go over the enclosed copy of your remarks to assure that they are accurate, and return the transcript by May 10 with any necessary corrections.

In addition, Representative Joan Kelly Horn has requested that the following questions be directed to you for inclusion in the record:

1. Would you go along with the 10% overhead cut proposed by Congressman Lamar Smith?

2. What are your views on combining an increased exemption like that proposed by Congressman Frank Wolf and a tax credit like suggested by you?

Again, my thanks, and that of the other members of the Committee, for your participation.

Sincerely,

Pat Schroeder

PATRICIA SCHROEDER
Chairwoman

PS/jg
Enclosure

RESPONSE TO QUESTIONS POSED BY CONGRESSWOMAN JOAN KELLY HORN

THE MAXWELL SCHOOL
METROPOLITAN STUDIES PROGRAM

.....

May 7, 1991

Patricia Schroeder
U.S. House of Representatives
Select Committee on Children, Youth,
and Families
Room H2-385 Annex 2
Washington, DC 20515-6401

Dear Madam Chairwoman:

I enclose the edited transcript of my remarks before your committee, and a corrected statement for submission.

Ms. Horn asks two questions:

1. "Would I go along with the 10% overhead cut recommended by Congressman Smith?"

   My answer is an enthusiastic Yes

2. "What are my views on combining an increased exemption like that proposed by Congressman Frank Wolf and a tax credit like you suggested?"

   While I would prefer only a refundable child credit, I would as a next-best solution, go along with a higher exemption and a refundable child credit like that suggested in my testimony. However, I'd like to see the level of each and the specific revenue raising provision before signing on completely.

Thank you for allowing me to testify before your committee.

Best wishes,

Tim

Timothy M. Smeeding
Professor of Economics and Public Administration

TMS/ymd
Enclosure

400 MAXWELL HALL / SYRACUSE NEW YORK 13244-1090 / 315-443-9042
FAX 315-443-1081 / TELEX 940103

BRIGHAM YOUNG
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THE GLORY OF GOD
IS INTELLIGENCE

April 17, 1991

The Honorable Patricia Schroeder
Chair
Select Committee on Children, Youth and Families
U.S. House of Representatives
H2-385 HOB Annex 2
Washington, DC 20515-6401
Attn: Nancy Reder, Professional Staff

Re: Children's Allowance Tax Credits: A Statement for Inclusion in the Record of the April 15, 1991, Hearing on Taxation of Families

Dear Representative Schroeder:

Low-income families with children have significant income needs that are not currently being met by either the welfare system or the tax system. This letter explains how a refundable children's allowance tax credit could help meet those needs.[1] Please include a copy of this letter in the record of your committee's April 15, 1991, hearing on the Taxation of Families.

I. BACKGROUND

A. THE NEED FOR INCOME ASSISTANCE FOR LOW-INCOME FAMILIES WITH CHILDREN

1. Children in Poverty

Low-income families with children need income assistance to help bring themselves and their children out of poverty. For example, for 1987, some 32.5 million people were below the poverty threshold. Of these, roughly 13 million were under age 18, and roughly 3 million were under age 3.

The United States has no universal cash benefit program for low-income families with children. Instead, a variety of programs provide benefits to some, but not all, low-income families with children. Of the 32.5 million persons who were in poverty in 1987, only 11 million persons were in families that received Aid to Families with Dependent Children. Similarly, only 19.1 million poor persons participated in the food stamp program, just 58.7% of the poor population.

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[1] This letter draws upon the author's earlier articles: Forman, Beyond President Bush's Child Tax Credit Proposal: Towards a Comprehensive System of Tax Credits to Help Low-income Families with Children, 38 Emory L. J. 661-700 (1989); Forman, A Modest Proposal for Refundable Children's Allowance Tax Credits, 47 Tax Notes 853-56 (1990).

2. *The Foreign Experience*

Unlike the United States, most industrialized nations do provide a public, universal child benefit based on the presence and number of children in a family.[2] These benefits are modest: typically between 5 and 10 percent of average gross wages for each child. Nevertheless, they provide important income assistance to low-income families with children.

Some countries provide the child benefit through a direct cash family or children's allowance, while other countries provide the benefit as a combination of direct cash allowance and tax allowances. For example, Canada provides both family allowances and refundable child tax credits to its low-income families. For 1988, the Canadian family allowance was $32.80 (Canadian) per child for each month. Also for 1988, the maximum Canadian child tax credit for each eligible child was $559 (Canadian), plus an additional $100 (Canadian) per year for each child under age 7. The Canadian child tax credit is available on an advance payment basis.

B. SOME COMPREHENSIVE ALTERNATIVES FOR USING THE TAX SYSTEM TO HELP LOW-INCOME FAMILIES WITH CHILDREN

The United States does provide a "universal" deduction for personal exemptions; however, the deduction for personal exemptions provides little or no benefit to taxpayers with incomes below their applicable income tax thresholds. In this regard, the current $2,150 personal exemption deduction results in a tax savings of $602 to a taxpayer facing the 28% marginal tax rate, $322.50 to a taxpayer facing the 15% marginal tax rate, yet nothing at all to most low-income families with children. Consequently, as a means of having the income tax system provide income assistance to low-income families, many analysts have suggested replacing the personal exemption deduction with a refundable personal exemption tax credit.[3] In that regard, because $300 personal exemption tax credits would lift few low-income families out of poverty, some analysts have suggested a personal exemption credit amount of $600 or more.[4]

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[2] *See* Kamerman & Kahn, *Social Policy and Children in the United States and Europe*, in The Vulnerable 351, 363-365 (J. Palmer, T. Smeeding & B. Torrey eds. 1988); O'Higgins, *The Allocation of Public Resources to Children and the Elderly in OECD Countries*, in *id*. at 201, 211; Kamerman & Kahn, *What Europe Does for Single Parent Families*, Pub. Interest, Fall, 1988, at 70; A. Kahn & S. Kamerman, Income Transfers for Families with Children: An Eight-Country Study (1983).

Alternatively, some analysts have suggested replacing the current system of welfare programs with a comprehensive negative income tax[5] or with a credit income tax.[6] For example, a simple credit income tax system might provide every low-income family with a subsidy equal to one half of the difference between its income tax threshold and its income. Under such a proposal, in 1991, a family of four with no income would receive a subsidy of $6,825 (one $5,700 standard deduction and four $2,150 personal exemptions = $14,300; 1/2 x $14,300 = $7,150), and a family of four with $10,000 of income would receive a subsidy of $2,150 (1/2 x [$14,300 - $10,000]).

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[3] Over the years there has been a good deal of debate as to whether the positive tax system should account for dependents at all, and if the income tax system should account for dependents, whether it should account for them through deductions or through credits. *See* Brannon & Morss, *The Tax Allowance for Dependents: Deductions versus Credits*, 26 Nat'l Tax J. 599 (1973); Brazer, *The Federal Income Tax and the Poor: Where Do We Go From Here?*, 57 Cal. L. Rev. 422 (1969); Gottschalk, *Deductions versus Credits Revisited*, 29 Nat'l Tax J. 221 (1976); Habib, *Horizontal Equity with Respect to Family Size*, 7 Pub. Fin. Q. 283 (1979); Pogue, *Deductions Versus Credits: A Comment*, 27 Nat'l. Tax. J. 659 (1974); Robinson, *The Treatment of Dependents Under the Personal Income Tax*, 18 Canadian Tax J. 44 (1970); Sayeed, *Choosing Between Tax Credits and Exemptions for Dependent Children*, 33 Can. Tax J. 975 (1985); Schenk, *Simplifying Dependency Exemptions: A Proposal for Reform*, 35 Tax Law. 855 (1982); Sunley, *The Choice between Deductions and Credits*, 30 Nat'l Tax J. 243 (1977); Thirsk, *Giving Credit Where Credit is Due: The Choice Between Credits and Deductions Under the Individual Income Tax in Canada*, 28 Canadian Tax J. 32 (1980); Turnier & Kelly, *The Economic Equivalence of Standard Tax Credits, Deductions and Exemptions*, 35 U. Fla. L. Rev. 1003 (1984); Weidenbaum, *Shifting from Income Tax Deductions to Credits*, 51 Taxes 462 (1973); Weidenbaum, *The Advantages of Credits in the Personal Income Tax*, 42 Geo. Wash. L. Rev. 516 (1974).

[4] *See, e.g.*, Lerman, *Separating Income Support from Income Supplementation*, 10 J. Inst. for Socioeconomic Stud. 101 (1985); S. Danziger, Tax Reform, Poverty, and Inequality 22-23 (U. Wis. Inst. for Research on Poverty Discussion Paper 829-87, 1987).

[5] *See, e.g.*, M. Friedman & R. Friedman, Capitalism and Freedom 174-75 (1962); C. Green, Negative Taxes and the Poverty Problem (1967); Lampman, *Approaches to the Reduction of Poverty*, 55 Am. Econ Rev. 521 (1965); Lampman, *Prognosis for Poverty*, in Nat'l Tax A., Proc. of The Fifty-Seventh Annual Conf. on Taxation 71, 71-81 (1964); Tobin, *Improving the Economic Status of the Negro*, 94 Daedalus 878 (1965); Tobin, Pechman & Mieszkowski, *Is a Negative Income Tax Practical?*, 77 Yale L. Rev. 1 (1967); Comment, *A Model Negative Income Tax Statute*, 78 Yale L.J. 269 (1968).

In the long run it may be desirable to move towards a credit income tax or a similar comprehensive income maintenance system. At present, however, the political situation makes such an approach untenable. First, the public debt and the budget deficits are so large that the federal government is not likely to adopt such a large program. Second, a comprehensive income assistance program would replace many existing welfare programs, and each of those programs is likely to have a constituency that would oppose such a major change. Finally, any across-the-board cash transfer program might raise serious questions about welfare dependency and adverse work incentives.

On the other hand, the political situation is ripe for providing additional income assistance to help the 13 million children who live in families with incomes below the poverty threshold. First, with numerous baby-boomer constituents now having their own children, both the President and Congress can reap political gains by doing something to help children generally and poor children specifically. Second, a modest program to provide income assistance to children in low-income families would not necessarily have to replace any existing programs. Third, the usual concerns about welfare dependency and work incentives are less important when children are considered, as children are not expected to work.

II. A MODEST PROPOSAL FOR A REFUNDABLE CHILDREN'S ALLOWANCE CREDIT

To provide additional income assistance to low-income families with children, I suggest that a refundable children's allowance tax credit be added to the Internal Revenue Code.[7] The credit should be significant in amount, indexed for inflation, and eligible recipients should be allowed to elect advance payment of the credit. Also, the credit should be made

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[6] *See*, *e.g.*, Cohen, *Administrative Aspects of a Negative Income Tax*, 117 U. Pa. L. Rev. 678 (1969); Curran, *Taxation and the Relief of Poverty*, 25 Rev. Soc. Econ. 107 (1967); Rolph, *The Case for a Negative Income Tax Device*, 6 Ind. Rel. 155 (1967); Surrey, *Income Maintenance Programs*, 24 Tax L. Rev. 305 (1969).

[7] *Cf*. Brazer, *supra* note 3, at 440-49.

available to all low-income families with children under age 13.

A. THE AMOUNT OF THE CREDIT

Initially, the maximum refundable children's allowance credit should be $1,075 per eligible child. A family of four with two eligible children would thus receive a children's allowance credit of up to at least $2,150 each year. To ensure that the amount of the credit is not eroded as a result of future inflation, the credit amount should be fixed at 50 percent of the personal exemption amount, currently $2,150. At least initially, the credit could be in addition to the current personal exemption deduction with respect to eligible children, but could phase-out at relatively low incomes so that few families would receive both benefits.

B. ELIGIBLE CHILDREN

Initially, a family should be allowed to claim a children's allowance tax credit for each child in the household who is a qualifying individual within the meaning of the child and dependent care credit. That is, each family should be allowed to claim the credit with respect to each child of the taxpayer under age 13 and older children who are physically or mentally incapable of self-care. In the future, Congress might well want to extend the definition of eligible individuals to cover all children under age 18. Eventually, Congress might want to expand eligibility to cover all dependents. Ultimately, Congress might even want to replace the personal exemption deduction with a personal exemption tax credit.

C. CLAIMING THE CREDIT

In general, a children's allowance tax credit could be claimed on an income tax return in much the same way that the personal exemption is claimed. There would be few additional administrative burdens. Tax returns already ask taxpayers to identify any dependents that they claim. Also, eligible families should be allowed to receive advance payment of their anticipated credit amounts by filing a proper form with their employer or with a bank or social service agency.

D. COST CONSIDERATIONS

Admittedly, children's allowance tax credits would be expensive, but needed revenues could come from a variety of sources. For example, extending the 31% marginal tax rate to all high-income taxpayers would raise billions of dollars and would help restore faith in the fairness of the income tax. Similarly, repealing some of the billions of dollars of special-interest tax expenditures could generate revenues that could be used to expand the system of refundable tax credits. Revenues could also be shifted to a system of refundable tax credits from other income security programs or from the current personal exemption deduction.

CONCLUSION

Low-income families with children have significant income needs that are not currently being met by either the welfare system or the tax system. Congress could use refundable children's allowance tax credits to directly address those income needs. All in all, a system of tax credits including a children's allowance tax credit, an expanded and refundable child and dependent care credit, and an expanded earned income credit would go a long way towards bringing low-income families with children out of poverty. Indeed, such a comprehensive system of tax credits ultimately could replace most of the existing welfare system.

Respectfully submitted,

Jonathan Barry Forman

Jonathan Barry Forman
Visiting Associate Professor[8]

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[8] Permanent position: Associate Professor, College of Law, University of Oklahoma, 300 Timberdell Road, Norman, Oklahoma 73019.

PREPARED STATEMENT OF SENATOR DAN COATS, A SENATOR FROM THE STATE OF INDIANA

First, I would like to offer my deepest appreciation to Chairwoman Schroeder, Select Committee Ranking Minority Member Wolf and the rest of the Select Committee on Children, Youth and Families for holding these hearings on family tax policy.

April 15th, the day in which Americans put the finishing touches on their tax returns, is a good time to begin what I hope will be an exhaustive inspection of the decline of the economic status of the family. This decline has been caused, in large part, by tax burdens on families with children-- burdens accumulated through decades of neglect.

These hearings will provide an important forum to defend the interests of the American family and I hope they will begin a process that will end in important changes in the tax code.

In particular, I think we must focus our efforts on restoring the value of the personal exemption. As you know, the personal exemption was designed to protect American families and children from tax burdens they should not be asked to bear. But that protection, in large part, has failed.

Since 1950, families have watched their personal exemption as a percent of median family income drop from 18.1 percent to 5.8 percent in 1989.

In fact, this amount would be even lower if legislation I advocated here in the House had not succeeded in doubling the personal exemption in the 1986 Tax Reform Act.

The initial cause of the steady decline in the personal exemption was an oversight. Congress had failed to apply indexation for the inevitable increases in the costs of living and the costs of raising children. Once this error was realized, however, Congress chose to ignore it. In doing so, it placed a greater value on assisting, within the tax code, special interests, and sustaining government programs and a government bureaucracy which have grown out of control -- all at the expense of the American family.

Within the past few years, the economic health of the American family had declined to such an extent that an indexation for inflation was finally applied to the personal exemption. But before this belated action was taken, America saw a significant increase in families that must have two incomes to survive. It saw a dramatic drop in the ability of families to feed, house, clothe, educate and provide adequate medical care for their children.

For many years I have worked for a fair and adequate personal exemption rate. But the past was just prelude. I am now proposing to double the exemption again, increasing its value to 11.7 percent of the median family income. In fact, the personal exemption needs to be tripled to meet its 1950 level, but current budget realities must delay that goal, at least for this Congress.

In effect, my bill will increase the personal exemption to $4,000, and index that new figure for inflation. This action is not only fair, it is long over due.

It will allow families to meet their own urgent needs with their own resources, without the synthetic sympathy of new government programs that provide little and care less. It will help set right an inequity steadily developed over decades of political apathy. And it will redirect the focus of our government toward sustaining one of the most fundamental predictors of our future -- the health of the American family.

This must be at the top of our domestic agenda. Lawmakers need to be made aware of the family's silent suffering. It is time for families to be heard in Congress, above the louder voices of special preference. It is time to create a tax code that is family friendly.

This Committee is working to focus the attention of the Congress and the nation on this cause, rooted in justice and need. I thank the Members for allowing me to make the case for doubling the personal exemption. Your support of this legislation is a symbol of an emerging consensus that families need our help, and deserve our respect.

○